



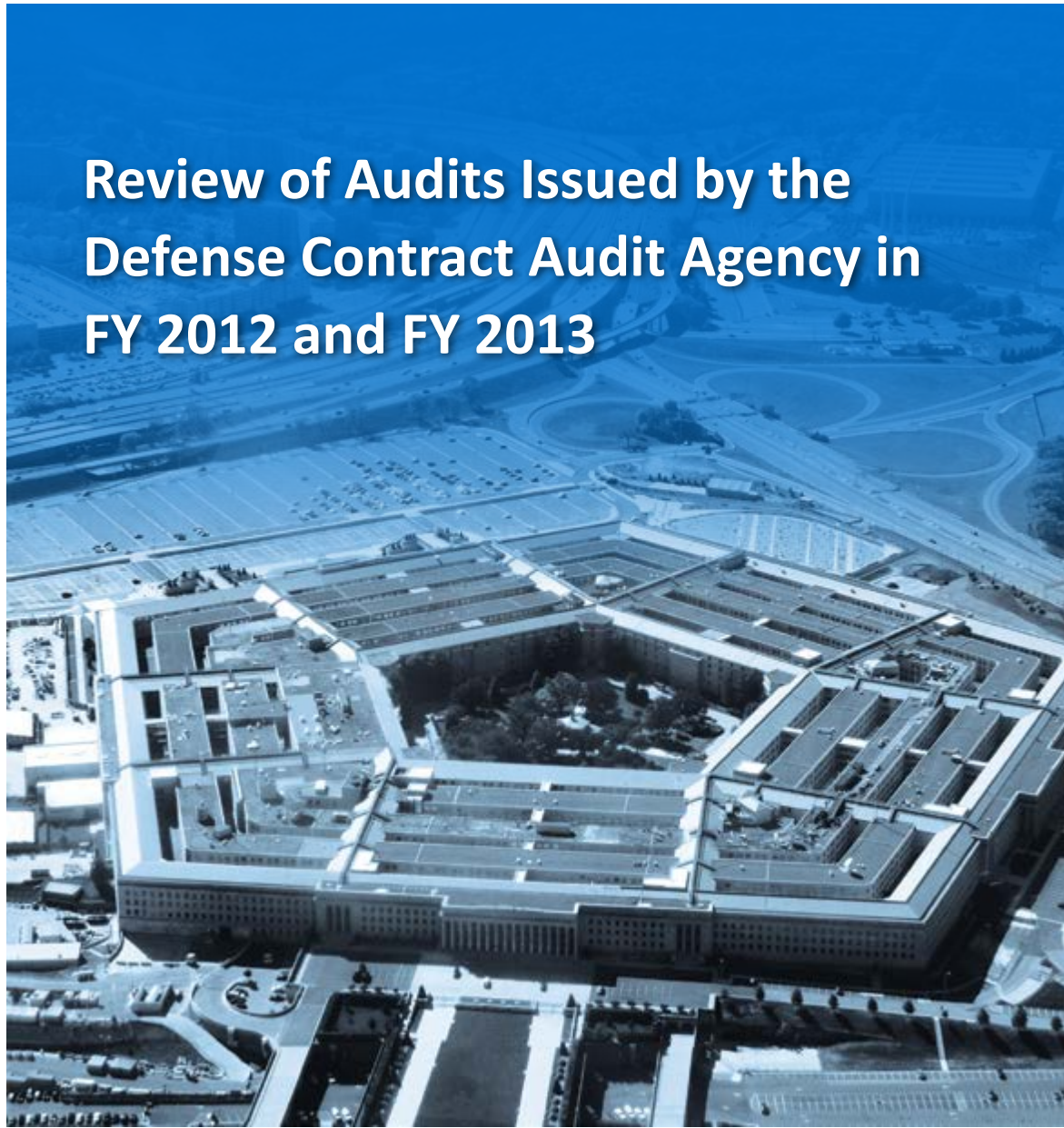
INSPECTOR GENERAL

U.S. Department of Defense

SEPTEMBER 8, 2014



Review of Audits Issued by the Defense Contract Audit Agency in FY 2012 and FY 2013



INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

Mission

Our mission is to provide independent, relevant, and timely oversight of the Department of Defense that supports the warfighter; promotes accountability, integrity, and efficiency; advises the Secretary of Defense and Congress; and informs the public.

Vision

Our vision is to be a model oversight organization in the Federal Government by leading change, speaking truth, and promoting excellence—a diverse organization, working together as one professional team, recognized as leaders in our field.



For more information about whistleblower protection, please see the inside back cover.



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

September 8, 2014

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

**SUBJECT: Review of Audits Issued by the Defense Contract Audit Agency
in FY 2012 and FY 2013
(Report No. DODIG-2014-109/Project No. D2013-DAPOCF-0004.000)**

We are providing this memorandum for your review and comment. We performed an evaluation of 16 Defense Contract Audit Agency (DCAA) audits and identified deficiencies with generally accepted government auditing standards in the areas of audit planning, evidence, working paper documentation, and supervision. In addition, our review disclosed instances of auditors not obtaining adequate cost or pricing data.

We considered management comments on a draft of this memorandum. DoD Directive 7650.3 requires that recommendations be resolved promptly. Comments provided by the Defense Contract Audit Agency were partially responsive. We request that management reconsider its position and provide comments by October 8, 2014.

Table 1. Number of Recommendations Requiring DCAA Comment

Memorandum Number	Number of Recommendations Requiring Comment
Memorandum No.2	4
Memorandum No.3	1
Memorandum No.5	1
Memorandum No.8	6
Memorandum No.11	2
Memorandum No.13	6
Memorandum No.14	1

Review Objective

As part of our oversight responsibility of DCAA, we evaluated a cross section of 16 DCAA audits completed between October 2011 and February 2013, including 5 audits of forward-pricing proposals and 11 audits of incurred cost proposals and other audit types. We reviewed the audits primarily to determine whether DCAA:

- correctly applied applicable acquisition regulations and DCAA policy;
- determined the adequacy of contractor cost or pricing data (if applicable);
- gathered sufficient evidence in support of the reported opinion; and
- issued an audit report that adequately explained the audit findings and met the contracting officer's needs.

At the conclusion of each review, we issued a memorandum that identified the findings and recommendations. The memoranda (see Attachments 1 through 16) served to timely alert DCAA of any deficiencies we uncovered and to recommend that DCAA initiate corrective action.

This evaluation focused primarily on DCAA's compliance with applicable regulations and certain aspects of DCAA policy on 16 audits. On August 21, 2014, the DoD Inspector General issued a "Pass with Deficiency" rating to DCAA after performing a peer review on DCAA's system of quality control. We did not evaluate the DCAA system of quality control or perform a comprehensive review of the 16 selected audits for compliance with all professional standards.

Findings

We identified 1 or more significant inadequacies associated with 13 of the 16 DCAA audits. Our review of the 5 forward-pricing proposal audits disclosed instances when DCAA did not:

- sufficiently advise contracting officers on the adequacy of cost or pricing data (see Attachments 2, 5, 10, 11, and 13);
- adequately review the proposal for compliance with Cost Accounting Standards (CAS) (see Attachments 2, 5, and 13);
- consider the work of a technical specialist (see Attachments 2, 5, 10, and 13);
- obtain sufficient evidence to support the opinion (see Attachments 2, 5, and 11);
- obtain access to contractor accounting records (see Attachments 2 and 13); or
- effectively communicate with the contracting officer (see Attachment 11).

For the 11 incurred cost and other audits, we found examples when DCAA did not:

- effectively plan the audit (see Attachments 1, 3, 6, 8, 14, 15, and 16);
- obtain sufficient evidence to support the opinion (see Attachments 3, 6, 8, and 9);
- appropriately supervise the audit (see Attachments 1, 3, and 15);
- adequately document the work performed (see Attachments 1, 6, 9, and 15);
- issue a report that correctly conveyed the findings (see Attachments 3, 6, and 16); or
- accurately calculate recommended penalties (see Attachments 6, 9, and 15).

Management Actions

For two memoranda (Attachments 1 and 6), DCAA management provided us with adequate written comments and planned corrective actions in response to seven recommendations. See Attachments 1-A and 6-A for the complete text of DCAA's comments. We require no additional comments on these two memoranda.

Recommendations, Management Comments and Our Response

We recommend that the Defense Contract Audit Agency:

- 1. Submit written comments on the findings and recommendations contained in Attachments 2, 3, 5, 8, 9, 10, 11, 13, 14, 15, and 16.**

DCAA Comments and Our Response

Of the 87 recommendations contained in these 11 attachments, DCAA agreed with 63 and did not agree with 24. We request that DCAA reconsider its responses to 21 of the 24 recommendations for which DCAA did not concur. See Attachment 17 for a summary of the DCAA management comments and our response to each comment. The full text of the management comments is included as Attachment 18.

- 2. Provide training to all audit staff on the proper handling of superseded working papers.**

DCAA Comments

DCAA agreed in principle that all auditors should be aware of how to properly handle superseded working papers. DCAA believes the required training and guidance currently provided to auditors is sufficient to address the recommendation.

Our Response

The management comments are responsive, and no further comments are required.

3. **Improve the reliability and accuracy of recommended penalties by:**
 - a. **providing training to all audit staff covering the computation of recommended penalties and**
 - b. **assessing the adequacy of, and making improvements to, existing Defense Contract Audit Agency policies and procedures to help ensure auditors correctly compute recommended penalties in accordance with Federal Acquisition Regulation 42.709.**

DCAA Comments

DCAA agreed and stated the Agency is undertaking a project that will ensure a consistent understanding of what cost principles are expressly unallowable. Once completed, DCAA will incorporate the results of the project into existing training on the calculation of recommended penalties.

Our Response

The management comments are responsive, and no further comments are required.

Scope and Methodology

We conducted this review from March 2012 through June 2013 in accordance with the Council of the Inspectors General on Integrity and Efficiency “Quality Standards for Inspection and Evaluation.” We selected 16 audits from a listing of DCAA reports issued between October 2011 and February 2013. The following table lists the number of audits by audit type and DCAA region.

Table 2. Number of Audits Selected for Review by Type and Location

Type of Audit	Field Detachment	Central	Eastern	North-Eastern	Mid-Atlantic	Western	Totals
Price Proposal		1		1	1	2	5
Incurred Cost	1		1	1	1	2	6
Termination	1						1
Iraq Direct Cost		1					1
CAS					1		1
Business Systems						2	2
Totals	2	2	1	2	3	6	16

To accomplish our objective, we obtained a copy of each audit working paper package, interviewed appropriate DCAA employees, and examined relevant documents.

Use of Computer-Processed Data

In selecting audits, we relied on a DCAA listing of reports from FYs 2012 and 2013 generated from the DCAA Management Information System. We did not selectively test the listing for accuracy and completeness. However, the listing had no impact on the results of our review of the 16 audits.

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and DoD Inspector General (IG) have issued several reports related to the quality of DCAA audits. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov/> and unrestricted DoD IG reports can be accessed at <http://www.dodig.mil>.

On August 21, 2014, the DoD Inspector General issued a “Pass with Deficiency” rating to DCAA based on the performance of a peer review covering DCAA’s system of quality control in effect between January 1, 2013, and June 30, 2013. As part of the peer review, the DoD Inspector General examined 92 audits and found that 11 lacked sufficient documentation to understand the judgments and conclusions drawn by the DCAA auditor. The peer review involved a comprehensive review for compliance with the professional standards and the DCAA system of quality control.

In contrast to the peer review, this evaluation was focused primarily on DCAA's compliance with applicable regulations and certain aspects of DCAA policy. Like the peer review, we did find instances where the audit documentation did not comply with the GAGAS requirements for sufficiency of documentation. However, we did not perform a comprehensive review of the 16 selected audits for compliance with all professional standards or evaluate the DCAA system of quality control taken as a whole.

We appreciate the courtesies extended to our staff. Please direct any questions to Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), carolyn.davis@dodig.mil.

A handwritten signature in black ink, appearing to read 'R. Stone', with a long horizontal flourish extending to the right.

Randolph R. Stone
Deputy Inspector General
Policy and Oversight

Attachments:
As stated

Attachment 1



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22304-1500

MAY 23 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY CENTRAL REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment
No. 3321-2009K10180035 (APO HRR Memorandum No. 1)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 3321-2009K10180035. Our review of the audit assignment disclosed that the auditor did not appropriately adjust the audit scope for a significant amount of claimed costs which another field audit office had previously examined and the contracting officer had negotiated. In addition, we found that the auditor did not properly retain or supersede several working papers. The field audit office also overstated questioned costs by \$6,128,000 in the DCAA Defense Management Information System (DMIS).

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk." (also referred to as high-risk reviews) Our first selection under this high-risk review effort was DCAA Assignment No. 3321-2009K10180035.

Under Assignment No. 3321-2009K10180035, the DCAA Resident Office in Houston, Texas, examined the costs billed by a DOD subcontractor submitted under a Firm Fixed Priced Indefinite Delivery, Indefinite Quantity subcontract. The Resident Office performed the examination to determine the allowability, allocability, and reasonableness of the billed subcontract costs totaling \$53,212,513 in 35 subcontractor invoices. As part of the assignment, the auditor fully tested all 35 subcontractor invoices. On October 13, 2011, the Resident Office issued Audit Report No. 3321-2009K10180035, questioning \$8,725,017 of the billed costs. Of this amount, the Resident Office questioned \$7,164,600 as unreasonable in accordance with Federal Acquisition Regulation (FAR) 31.201-3, and \$1,560,417 as unallowable per FAR 31.201-2, Determining Allowability.

Objective and Scope of High-Risk Review

We reviewed Assignment No. 3321-2009K10180035 to determine if the Resident Office in Houston, Texas:

- correctly applied appropriate criteria such as the FAR, Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards;
- followed Agency procedures and guidance;

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Attachment 1 (cont'd)

- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, interviewed appropriate DCAA employees, and reviewed other relevant documents. As part of the interviews, we placed employees under oath, we recorded the interviews, and we obtained a transcription of the recordings. We did not perform a comprehensive review of Assignment No. 3321-2009K10180035 for compliance with all generally accepted government auditing standards.

Results of High Risk Review

Unnecessary Audit Effort

Our review disclosed that the Resident Office in Houston, Texas, examined a significant amount of costs which were previously audited by another DCAA office and negotiated by the contracting officer. As detailed below, we found that 66 percent of the invoices and 59 percent of the claimed costs audited in Assignment No. 3321-2009K10180035 had already been examined in an assist audit conducted by the DCAA Iraq Branch Office, under Assignment No. 2131-2007R10180002-S1.

Table. Invoices and Costs Previously Examined and Questioned

	Prior Assignment No. 2131- 2007R10180002-S1	Assignment No 3321- 2009K10180035	% Examined/Quest. In Prior Assignment
No. of Examined Invoices	23*	35	66%
Costs Included in Examined Invoices	\$31,418,833*	\$53,212,513	59%
Questioned Costs	\$ 7,977,213*	\$ 8,725,017	91%

*These amounts include those reported in DCAA Form I No. 135, May 30, 2008.

In addition, 91 percent of the costs questioned had previously been questioned by the DCAA Iraq Branch office. On May 30, 2008, DCAA issued a Form I to suspend the costs questioned in prior Assignment No. 2131-2007R10180002-S1. On July 15, 2010, the contracting officer reached a negotiated settlement with the contractor on the questioned costs included in the DCAA Form I. Therefore, the Resident Office's efforts to later re-examine the same invoices and re-question the same costs did not serve a useful purpose.

The Resident Office should have tailored the audit scope to exclude or limit its review of the 23 invoices that the Iraq Branch Office previously examined, and the questioned costs that the contracting officer had already negotiated. The Resident Office could have saved a

Attachment 1 (cont'd)

significant amount of scarce audit resources if it had appropriately tailored the audit scope. Resident Office auditors expended 899 hours on Assignment No. 3321-2009K10180035. In addition, the reporting of the same questioned costs likely resulted in wasted effort on the part of the contracting officer by having to re-address questioned costs he previously negotiated.

Our interviews disclosed that the Resident Office supervisor might have given inappropriate guidance in establishing the audit scope under Assignment No. 3321-2009K10180035. According to one of the auditors we interviewed, the auditor alerted the supervisor of the negotiated questioned costs but the supervisor incorrectly advised the auditor to still perform a full examination of all invoices. The Resident Office, a frequent recipient of assist audits from field audit offices, should be provided training on the proper tailoring of audit scope for assist audit results and negotiated settlements.

Removal of Superseded Working Papers

We noted that several auditors had worked on Assignment No. 3321-2009K10180035 but were reassigned to perform other audits before the assignment's completion. Our review disclosed that the last auditor who worked on, and completed Assignment No. 3321-2009K10180035 (hereafter referred to as the "last auditor") did not properly retain or supersede working papers prepared by a prior auditor in accordance with DCAA procedure. DCAA Contract Audit Manual (CAM) 4-403f.(2) states:

Superseded working papers should be clearly identified as such and include any working papers prepared during the course of the audit that do not support or are not relevant to the conclusions in the audit report. This will include, for example, working papers changed due to revisions in audit methodology that are not relevant to the audit conclusions.

On October 15, 2010, approximately 9 months before the last auditor began working on the assignment, DCAA issued Memorandum For Regional Director (MRD) 10-PAS-29(R) to announce the above policy and to emphasize the retention of all working papers, including superseded working papers.

We obtained an earlier, unofficial version of the working papers from one of the prior auditors (hereafter referred to as the "prior auditor") and compared it to the official working papers for Assignment No. 3321-2009K10180035. Our comparison disclosed that the last auditor had significantly revised 19 of the prior auditor's working papers by re-writing working paper narrative, deleting the prior auditor's initials, and inserting his own initials. The last auditor did not retain the original working papers or label them "superseded" in accordance with the above procedure. In the case of four additional working papers, the last auditor did not change the prior auditor's working paper narrative, but he replaced the prior auditor's initials with his own. As a result, the official working papers contain little evidence of the prior auditor's work performed or conclusions reached, even though the prior auditor incurred 543 hours on the assignment. In addition, the official working papers fail to adequately explain why the last auditor changed the prior auditor's scope and conclusions. CAM 4-403f.(1) requires auditors to adequately describe the reason for any revisions to the original audit scope.

Attachment 1 (cont'd)

The supervisor acknowledged he might have incorrectly advised the last auditor to retain only those working papers which support the final reported conclusions. Such advice likely gave the last auditor the false impression he could remove the prior auditor's working papers from the official working paper package.

On April 3, 2012, approximately one week after we conducted our interviews, the Resident Office provided training on the proper handling of superseded working papers to its staff. The purpose of the training was to eliminate any misconceptions about superseded working papers and to reiterate the requirement to retain all work papers. As a result, we have no additional recommendations for this finding.

Overstatement of Questioned Costs in DMIS

We found that the Resident Office reported \$8,725,017 of questioned costs in the DCAA DMIS, even though the Iraq Branch Office had previously reported \$6,128,000 of the same questioned costs in the DMIS. The Resident Office should have only reported the difference of \$2,597,017, resulting in the overstatement of \$6,128,000. The accuracy of DMIS information is important because DCAA frequently uses it as a management tool, and DCAA reports key statistics from DMIS to Congress and various federal agencies.

We do not know the extent to which the Resident Office might have incorrectly reported questioned costs in DMIS on other assignments. However, the Resident Office frequently receives assist audits from various field audit offices like the Iraq Branch Office, and the Resident Office could therefore be using the same flawed reporting methodology in several other instances. The Resident Office should review its procedures and internal controls for DMIS reporting and make appropriate improvements for helping to ensure the accurate reports of questioned costs in DMIS.

Recommendations

We recommend that the Director, Defense Contract Audit Agency direct the Regional Director, DCAA Central Region to:


1. Provide training to all Resident Office audit staff on how to properly tailor the audit scope for the receipt of assist audits and negotiated settlements.
2. Review the Resident Office procedures for reporting questioned costs in DMIS and make appropriate improvements to help ensure the accurate reporting of those costs.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the factual matters discussed in this memorandum in advance of the draft report.

Attachment 1 (cont'd)

We appreciate the courtesies extended to my staff. If you have any questions, please
contact [REDACTED] or [REDACTED]


Carolyn Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 1-A



**CENTRAL REGION
DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
6321 EAST CAMPUS CIRCLE DRIVE
IRVING, TX 75063-2742**

RAME-3

September 28, 2012

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment
No. 3321 – 2009K10180035 (APO HRR Memorandum No. 1)

The DoD-IG reviewed the [REDACTED] Resident Office's Assignment No. 3321-2009K10180035 and reported its conclusions from its review by memorandum dated May 23, 2012. The DoD-IG concluded the following:

1. The [REDACTED] Resident Office did not appropriately adjust the audit scope for a significant amount of claimed costs which the Iraq Branch Office examined in 2007, and whose costs were suspended on DCAA Form 1 Notice No. 135 and negotiated by the cognizant ACO on July 15, 2010.
2. The auditor that completed the assignment did not properly retain or supersede several working papers in the Assignment No. 3321-2009K10180035 working paper file.
3. The [REDACTED] Resident Office reported \$6,128,000 of questioned costs in the DCAA Defense Management Information System (DMIS) under Audit Report No. 3321-2009K10180035 which duplicated questioned costs previously reported by the Iraq Branch Office under Audit Report No. 2131-2007R10180002 in 2007.

As a result of the findings listed above, the DoD-IG made recommendations regarding items 1 and 3. The DoD-IG did not make recommendations regarding retaining and/or superseding working papers because the FAO conducted training on that subject shortly after the DoD-IG evaluator completed employee interviews at the [REDACTED] Resident Office.

The DoD-IG recommendations and the Central Region responses to those recommendations follow:

Recommendation 1. Director, Defense Contract Audit Agency should direct the Regional Director, DCAA Central Region to provide training to all Resident Office audit staff on how to properly tailor the audit scope for the receipt of assist audits and negotiated settlements.

DCAA Response to Recommendation 1. The Central Region will provide training to all audit staff at the [REDACTED] Resident Office on how to properly tailor the audit scope for the receipt of assist audits and negotiated settlements by October 31, 2012. The training will be provided at a scheduled Field Audit Office Staff Conference.

Attachment 1-A (cont'd)

RAME-3

September 28, 2012

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment
No. 3321 – 2009K10180035 (APO HRR Memorandum No. 1)

Recommendation 2. Director, Defense Contract Audit Agency should direct the Regional Director, DCAA Central Region to review the Resident Office procedures for reporting questioned costs in DMIS and make appropriate improvements to help ensure the accurate reporting of those costs.

DCAA Response to Recommendation 2. The Central Region will review the [REDACTED] Resident Office's procedures for reporting questioned costs in DMIS and make appropriate improvements to help ensure the accurate reporting of those costs. The [REDACTED] Resident Office Assistant for Quality will prepare a presentation on accurately reporting the results of audit in DMIS in accordance with Appendix A of the DMIS User's Guide. The review of the [REDACTED] Resident Office's procedures for reporting questioned costs in DMIS and the FAO Assistant of Quality presentation will take place by October 31, 2012.

Please direct any questions to [REDACTED]

[REDACTED] or the undersigned at [REDACTED].

//signed//

TIMOTHY C. CARR
Regional Director

Attachment 2



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

JUL 18 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Results of DoD OIG High Risk Review – DCAA Audit Report No. 3141–2011M21000001, (APO HRR-FP Memorandum No. 2)

This memorandum sets forth the results of our oversight review of DCAA Audit Report No. 3141–2011M21000001 *Independent Audit of [REDACTED] Defense, LLC's [REDACTED] Proposal under Contract Number [REDACTED]* issued by the Chicago Branch Office on October 17, 2011. The review is being performed under DoDIG Project No. D2012-DIP0AI-0013. Our oversight review disclosed:

- DCAA audited an inadequate proposal (Finding A),
- [REDACTED] Defense LLP did not provide records requested by DCAA and DCAA did not pursue access to the records (Finding B),
- DCAA did not determine compliance with Cost Accounting Standard 401 (Finding C),
- DCAA requested DCMA technical assistance without testing the [REDACTED] Defense data (Finding D), and
- The DCAA audit report does not reflect the audit work performed (Finding E).

The audit report should be rescinded and the contracting officer should be advised not to rely on the audit report as a basis to evaluate (i) the adequacy of all contractor submitted cost or pricing data and (ii) contractor compliance with appropriate provisions of FAR Part 31 and the Cost Accounting Standards when negotiating a contract price for the [REDACTED] (vehicles).

Background

We selected DCAA Assignment No. 3141–2011M21000001 for oversight review as a part of our responsibility to perform oversight of DCAA audits.

On May 27, 2011, the DoD [REDACTED] Program Office (JPO) requested DCAA audit the [REDACTED] Defense) May 19, 2011, proposal for 250 vehicles with a proposed price of \$49,418,592. The contractor submitted its proposal in the 'add/delete' format provided for change orders, modifications, and claims in accordance with FAR 15.408, Table 15-2, Part III - Format for Submission of Line Item Summaries, as follows:

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Attachment 2 (cont'd)

Summary, [REDACTED] Defense proposal for 250 vehicles

Cost Elements	Proposed Cost
Added material costs	\$86,035,370
Deleted material costs	(51,544,198)
Labor and other costs	6,727,583
Proposed cost before profit	\$41,218,755
Profit	8,199,837
Net Proposed Price	\$49,418,592

[REDACTED] Defense completed production of all 250 vehicles to be acquired under the proposal and made delivery of the last unit to the U. S. Government (USG) on March 28, 2011, which was 52 days prior to submitting its proposal to the [REDACTED] JPO. Consequently, the [REDACTED] Defense proposal should have been based on actual costs incurred for all 250 vehicles and not estimated costs.

Objective and Scope of High-Risk Review

The purpose of our oversight review is to evaluate whether the DCAA audit case file documentation (audit working papers) demonstrate that DCAA:

- Evaluated the contractor's proposal for compliance with FAR, CAS and existing DCAA policy,
- Determined the adequacy of contractor cost or pricing data, and
- Performed work sufficient to support the audit opinion on the acceptability of the contractor's proposed costs for negotiation of a fair and reasonable price.

Results of High-Risk Review

Finding A. DCAA audited an inadequate proposal

DCAA audited the [REDACTED] Defense May 19, 2011 proposal which was based on estimated costs. However [REDACTED] Defense had completed and delivered all 250 vehicles 52 days prior to submitting its proposal to the JPO. FAR 15.408, Table 15-2, Part I – General Instructions, paragraph (F) provides the following guidance for contractor use when submitting a proposal with cost or pricing data:

Whenever you have incurred costs for work performed before submission of a proposal, you must identify those costs in your cost/price proposal.

Attachment 2 (cont'd)

On July 11, 2011, DCAA reviewed the [REDACTED] Defense May 19, 2011 proposal¹ for adequacy but incorrectly concluded that incurred costs were not applicable. Available DD Form 250 Material Inspection and Receiving Reports demonstrate that [REDACTED] Defense had delivered all 250 vehicles included in the proposal by March 28, 2011. However, DCAA never requested that [REDACTED] Defense provide the incurred costs for all 250 vehicles for audit examination. Consequently, DCAA did not obtain and audit the actual costs [REDACTED] Defense incurred in producing and delivering all 250 vehicles and DCAA did not compare the actual incurred costs to the estimated costs that formed the basis of the [REDACTED] Defense proposed price of \$49,418,592 for a determination of cost reasonableness.

Recommendation A

By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should:

1. Implement a procedure requiring that the auditors provide positive assurance through inquiry with the contracting officer and contractor that incurred costs have been appropriately included in the contractor's proposal submission in accordance with FAR 15.408, Table 15-2, Part I – General Instructions, paragraph (F).
2. Provide training to the audit staff regarding DCAA audit policy for issuing audit reports where the contractor has submitted an inadequate proposal, including training on the appropriate use of a disclaimer of opinion.

Finding B. [REDACTED] Defense did not provide records requested by DCAA and DCAA did not pursue access to the records

DCAA did not notify the JPO contracting officer that the [REDACTED] Defense proposal was (i) either so deficient as to preclude an audit or (ii) that [REDACTED] Defense was denying DCAA access to its books and records. FAR 15.404-2(d) provides in part that:

The ACO or auditor, as appropriate, shall notify the contracting officer immediately if the data provided for review is so deficient as to preclude review or audit, or if the contractor has denied access to any records considered essential to conduct a satisfactory review or audit.

On July 28, 2011, DCAA requested [REDACTED] Defense provide access to the labor hours incurred and utilized in producing and delivering [REDACTED] Recovery Vehicles. On July 29, 2011, DCAA requested that [REDACTED] Defense provide the incurred labor hours "in order to verify cost reasonableness". [REDACTED] Defense in its August 3, 2011, response did not provide the incurred labor hours as requested by DCAA. Instead, [REDACTED] Defense requested that the Defense

¹ The DCAA 'Criteria for Adequate Contract Pricing Proposals' used by the auditors provides as its purpose that "Proposals should be evaluated for adequacy within seven days after receipt so that corrective action can be taken immediately (CAM 9-103). The [checklist criteria] can be used to evaluate the adequacy of a contract price proposal when the proposal is based on cost or pricing data..." and "Most of the criteria [are] specifically required by the Federal Acquisition Regulation (FAR) and are referenced accordingly."

Attachment 2 (cont'd)

Contract Management Agency (DCMA) engineer² validate the original estimate of proposed direct labor hours as a part of the DCMA technical engineering review. On August 5, 2011, the DCAA auditor advised [REDACTED] Defense that DCAA had its own audit to complete and requested [REDACTED] Defense provide the previously requested incurred labor hours. [REDACTED] Defense responded that the existing contract lacked a requirement to track and record actual labor hours and that this information was not available. [REDACTED] Defense never provided the requested incurred labor records.

DCAA audit policy at DCAM 1-504.5 *Resolution of Contractor Denials* provides procedures the auditor should follow when access to contractor records is not forthcoming. These include (i) attempting to resolve the issue with responsible contractor officials authorized to make decisions and (ii) following the procedures cited in DCAA Instruction 7640.17. If the performance of these procedures do not result in auditor access to the denied records, DCAM provides that the DCAA regional office should consider requesting that DCAA Headquarters subpoena the records in accordance with DCAA Regulation No. 5500.5. Finally, DCAM 1-504.6 provides that when the contractor denies the auditor access to records/data, the costs affected by the denial should be questioned under price proposal audits.

If a contractor's records are inadequate or not in a condition for audit, DCAM 1-506 provides that the auditor should immediately bring the deficiency to the contractor's attention. If the contractor does not take prompt corrective action, the auditor is to notify the regional office and the requesting procurement activity. DCAM 1-506c provides that any reports issued under these circumstances should contain appropriate comments on all the facts with any necessary disclaimer, adverse opinion, qualifications, and/or explanations of questioned costs.

DCAA did not comply with FAR 15.404-2(d) and notify the JPO contracting officer that either (i) the [REDACTED] Defense accounting records were so deficient as to preclude a review or audit of direct labor hours or (ii) that [REDACTED] Defense was not providing records considered essential to conduct a satisfactory audit. DCAA also did not comply with DCAM and pursue access to the requested incurred labor records or determine that the records were so deficient as to preclude an audit. Instead DCAA completed its audit and issued its audit report without ever having audited the [REDACTED] Defense incurred labor hour accounting records or determining that the records were so deficient as to preclude an audit.

Recommendation B

By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should provide the audit staff with training on FAR 15.404-2(d), DCAM 1-504 *Access to Records of Contractor*, and DCAM 1-506 *Other Access to Records Issues – Records Destroyed or Not in Condition for Audit* and should implement procedures for audit staff use in documenting and pursuing to completion any future instances of possibly deficient contractor accounting records or potential contractor denial of access to records.

² On August 1, 2011, DCAA requested DCMA technical engineering assistance with the evaluation of the [REDACTED] Defense proposed labor hours.

Attachment 2 (cont'd)

Finding C. DCAA did not determine compliance with Cost Accounting Standard 401

Without the requested [REDACTED] labor hour records, DCAA inappropriately determined that the [REDACTED] Defense proposal complied with 48 CFR 9904.401 Cost accounting standard – consistency in estimating, accumulating and reporting costs (CAS 401)³. FAR 15.404-1(c)(2)(iv) requires:

Verification that the offeror's cost submissions are in accordance with the contract cost principles in part 31 and, when applicable, the requirements and procedures in 48 CFR Chapter 99 (Appendix to the FAR loose leaf edition), Cost Accounting Standards.

48 CFR 9904.401-40(a) requires "A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs." The DCAA audit working papers provide that:

"[REDACTED] was unable to provide us with the actual labor hours behind their [basis of estimate] because they do not track and record actual hours";

"There is not enough information available to determine whether a CAS 401 noncompliance exists, as we do not have specific information regarding the labor hours for each category. We anticipate returning to this topic once we have received the [Defense Contract Management Agency] technical report"; and

"As [the Defense Contract Management Agency] was not able to obtain information from [REDACTED] regarding historical labor for direct labor hours, we believe [REDACTED] has a strong potential for a CAS noncompliance."

DCAA never pursued the requested [REDACTED] Defense accounting records sufficient to understand and evaluate the [REDACTED] Defense proposal for compliance with CAS 401 (see Finding B). Instead DCAA reported in Audit Report No. 3141-2011M21000001 that the [REDACTED] Defense proposal was prepared in compliance with applicable Cost Accounting Standards and that the proposed labor costs were 'unsupported.'

DCAA did not perform sufficient work to demonstrate compliance with CAS 401 and, by reporting the proposed labor costs as 'unsupported,' DCAA obscured the underlying issues that DCAA had left unanswered in its audit. DCAA policy at DCAM 10-304.8c provides that:

³ 48 CFR 9904.401-20 Purpose provides in part that "With respect to individual contracts, the consistent application of cost accounting practices will facilitate the preparation of reliable cost estimates used in pricing a proposal and their comparison with the costs of performance of the resulting contract. Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing accountability for cost in the manner agreed to by both parties at the time of contracting. The comparisons also provide an improved basis for evaluating estimating capabilities."

Attachment 2 (cont'd)

Costs should be classified as unsupported when the contractor does not furnish sufficient documentation to enable a definitive conclusion and the insufficiency is not caused by contractor denial of records.

DCAA should have pursued access to the [REDACTED] Defense records until such records were obtained. If the records could not be obtained, DCAA should have reported the proposed labor costs as questioned cost in accordance with DCAM 1-504. If DCAA had obtained the requested records and found they were so deficient as to preclude an audit, DCAA should have complied with DCAM 1-506 and reported all the facts with any necessary disclaimer, adverse opinion, qualifications, and/or explanations of questioned costs.

Recommendation C

1. By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office should establish procedures for supervisory auditor use in documenting the satisfactory resolution of any identified potential CAS noncompliances identified in the audit working papers.
2. By September 30, 2012, the DCAA Regional Audit Manager with cognizance of the Chicago Branch Office should implement quarterly reviews of the Chicago Branch Office. The quarterly reviews should determine whether any reported contractor unsupported costs are the result of a potential contractor denial of access to accounting records and data, and should document for the record the results of each quarterly review.

Finding D. DCAA requested DCMA technical assistance without testing the [REDACTED] Defense data

DCAA requested DCMA technical assistance in its examination of [REDACTED] Defense proposed direct labor hours and direct material kinds and quantities. DCAA did not make appropriate tests of the [REDACTED] Defense accounting data provided to and used by the DCMA engineer. DCAM D-101d provides that:

“The auditor is also required to make appropriate tests of accounting data provided to and used by the specialist.”

Regarding proposed direct labor hours, DCMA reported on Sept. 15, 2011 that it was:

“...unable to obtain supporting documentation (historical data, manufacturing router information, contract invoices etc) that was used by [REDACTED] to develop the summary information provided in the proposal. As a result, DCMA was not able to verify the direct labor hours required for wrecker integration.”

Regarding proposed material costs, DCMA reported on August 12, 2011 that:

Attachment 2 (cont'd)

“...DCMA could not confirm the delete [material] list as being neither reasonable nor unreasonable. The data provided was insufficient to complete the review”

And

“DCMA was unable to validate the completeness of the delete [material] list due to lack of access to an IBOM [indentured bill of material] from the vehicle where the delete list originated.”

Based upon the reports submitted by the DCMA technical specialist, DCAA reported [REDACTED] Defense proposed direct labor and deleted material costs as unsupported in DCAA Audit Report No. 3141-2011M21000001. However it was DCAA policy and a DCAA responsibility to ensure the accounting data provided to and used by the DCMA technical specialist was appropriate for use by such specialist in determining cost reasonableness. Had DCAA examined the [REDACTED] Defense accounting data to be used by the DCMA technical specialist prior to requesting assistance, the DCMA technical specialist could have been in a position to evaluate the reasonableness of the contractor's estimates.

Recommendation D

By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should provide the audit staff with training on the requirements of DCAM Appendix D and should implement procedures that ensure the auditors make appropriate tests of contractor accounting data provided to and used by the DCMA technical specialist.

Finding E. DCAA audit report does not reflect the audit work performed

On October 17, 2011 DCAA issued Audit Report No. 3141-2011M21000001. DCAA reported that the cost or pricing data submitted by [REDACTED] Defense to support \$51,544,198 of deleted material costs and \$688,198 of labor costs were not adequate. DCAA reported that the proposal was prepared in compliance with applicable Cost Accounting Standards and appropriate provisions of FAR Part 31. DCAA reported that “Because the cost or pricing data inadequacies are considered to have a significant impact on the proposal taken as a whole, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price...”

The DCAA audit report is not supported by the work documented in the audit working papers. The audit working papers demonstrate that:

- DCAA examined an inadequate contractor proposal that did not include [REDACTED] Defense costs incurred to produce all 250 proposed vehicles (Finding A),
- DCAA did not complete the examination of [REDACTED] Defense incurred labor hours for which DCAA had requested access but [REDACTED] did not provide (Finding B),
- DCAA did not properly examine [REDACTED] Defense labor hours for compliance with CAS 401 (Finding C), and

Attachment 2 (cont'd)

- DCAA did not make appropriate tests of the [REDACTED] Defense accounting data provided to and used by the DCMA technical specialist (Finding D).


Recommendation E

1. By August 1, 2012, the DCAA Branch Manager, Chicago Branch Office should:
 - a. Rescind DCAA Audit Report No. 3141-2011M21000001, dated October 17, 2011.
 - b. Advise the JPO contracting officer of the short-comings included in the audit and that the contracting officer should not rely on DCAA Audit Report No. 3141-2011M21000001, dated October 17, 2011 as a basis for negotiating a fair and reasonable price.
 - c. Recommend the JPO contracting officer obtain a new proposal from [REDACTED] that complies with FAR 15.408, Table 15-2, Part I – General Instructions, paragraph (F) and includes [REDACTED] Defense incurred cost for work performed in producing and delivering all 250 [REDACTED] Vehicles.
2. By September 30, 2012, the DCAA Regional Audit Manager with cognizance of the Chicago Branch Office should implement periodic reviews of proposal audit reports issued by the Chicago Branch Office to validate that the reported findings and recommendations are supported by the work performed and documented in the audit working papers.

Concluding Remarks

We do not require a formal written response from DCAA at this time. We plan to issue a formal draft report covering the results of multiple high-risk oversight reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on factual matters discussed in this memorandum in advance of the draft report.

If you have any questions, please contact the undersigned or [REDACTED] at [REDACTED] or by email at [REDACTED]


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

cc:
Assistant Director of Integrity and Quality Assurance
Regional Director, Central Region
Regional Audit Manager (RAMC-3), Central Region
Branch Manager, Chicago Branch Office, Central Region

Attachment 3



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

July 19, 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY WESTERN REGION

SUBJECT: Results of High Risk Review Regarding Audit Assignment No. 4551-
2009B11010001 (APO HRR Memorandum No. 3, Project No. D2012-DIP0AI-
0013.000)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 4551-2009B11010001, involving the audit of a contractor's billing system and related internal controls. Our review disclosed that the field audit office (FAO) spent an excessive number of hours auditing a billing system that is no longer in use, reported on transaction tests that were not current or relevant, and recommended the withholding of contractor payments without sufficient evidence.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk." (also referred to as high-risk reviews) Our second selection under this high-risk review effort was DCAA Assignment No. 4551-2009B11010001.

Under Assignment No. 4551-2009B11010001, an FAO in San Diego, California, examined the billing system internal controls for a major DOD contractor to determine if the system had significant deficiencies and material weaknesses. On November 17, 2011, the FAO reported that the billing system had 16 significant deficiencies which could have resulted in overstated interim and final vouchers. The FAO recommended that the contracting officer suspend a percentage of progress payments or reimbursed costs in accordance with Defense Federal Acquisition Regulation Supplement (DFARS) 242.7502.

During the planning and fieldwork stages of Assignment No. 4551-2009B11010001, the contractor transitioned from a Systems, Applications and Products (SAP)-based billing system (hereafter referred to as the "legacy" system) to a Deltek-Costpoint based billing system (hereafter referred to as the "new" system). The FAO elected to extensively test and report on both the legacy and new billing systems. The FAO statistically sampled and tested billing system transactions from both systems processed between December 1, 2007 and May 10, 2010, to support its reported opinion. FAO auditors spent 7,416 hours to complete the audit. The contractor completed the transition to the new billing system on January 22, 2010, nearly one year and 10 months before the FAO issued its report on November 17, 2011.

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Attachment 3 (cont'd)

Prior to Assignment No. 4551-2009B11010001, the FAO last reported in Audit Report No. 4171-2003B11010001, December 20, 2005, that the same contractor's billing system and related internal controls were adequate. In 2009, however, the Government Accountability Office (GAO) concluded that the FAO did not perform sufficient or adequate testing in support of the reported opinion in part because the testing was over two years old by the time the FAO issued the audit report (See Page 99 of GAO Report No. GAO-09-468). As a result, the FAO rescinded Report No. 4171-2003B11010001 on April 7, 2009.

Objective and Scope of High-Risk Review

We reviewed Assignment No. 4551-2009B11010001 to determine if the FAO:

- correctly applied appropriate criteria such as the Federal Acquisition Regulations, DFARS, and Cost Accounting Standards;
- followed key Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, conducted face-to-face interviews of appropriate DCAA employees, and reviewed other relevant documents. We did not perform a comprehensive review of Assignment Number 4551-2009B11010001 for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review disclosed that the testing performed by the FAO on the billing system was comprehensive and well documented. However, we also found that the FAO, (1) expended an excessive amount of time testing the legacy system, and (2) reported on the results of tests that were not current.

Excessive Testing of Legacy System

Based on our review of the working papers for Assignment No. 4551-2009B11010001, we learned that the FAO planned and conducted roughly an equal amount of sample tests for both the legacy and new billing systems. For both the legacy and new billing systems, FAO auditors conducted numerous sample tests of all relevant controls discussed in the standard DCAA billing system audit program. Although the working papers do not break out all hours incurred between the legacy and new systems, we estimate that FAO auditors dedicated approximately 48 percent of their time to reviewing and reporting on the legacy system, which equates to 3,560 hours of the 7,416 total hours charged to the assignment. In the planning stage of the assignment, the FAO manager instructed the lead auditor to expend about one-third of her time on the legacy system and two thirds on the new system.

We question the FAO's decision to plan and expend such a large amount of resources on a legacy system that would no longer be in use by audit completion. From the inception of the audit, the FAO knew the contractor was transitioning to the new billing system, and the

Attachment 3 (cont'd)

contractor would complete the transition by early 2010. Two of the contractor's major business units had already transitioned to the new system prior to the commencement of any audit field work, and the remaining business units were transitioned by January 23, 2010 (six months before completion of the FAO's transaction testing). The FAO explained to us that the auditors reviewed both billing systems because:

- both systems were operational during part of the time the FAO performed the testing; and
- some ongoing projects included costs that were converted from the legacy billing system.

While limited testing of the legacy system might have been justified, the FAO should not have expended the resources it did to audit a system that would not exist in the near term. The FAO should have significantly reduced its audit scope of the legacy system as a result of the transition. For example, rather than test all legacy system controls, the FAO could have justifiably limited its testing to those controls associated with the contractor's conversion of costs to the new system. Conducting a full audit of the legacy system internal controls was not useful to the contracting officer or reflective of the audit risk to the Government.

Our review of Agency guidance on audits of contractor business systems (including billings systems) disclosed no specific guidance on the tailoring of audit steps or approach while contractors transition from one system to another. The lack of agency-wide policies and procedures could result in significant wasted audit resources, and an inconsistent approach to auditing major business systems during a system transition. DCAA should develop such procedures to ensure that auditors take into account the limited risk associated with contractor business systems that will be phased out in the near future.

Non-Current Testing

The auditor tested contractor billing system transactions that took place between December 2007 and May 2010. However, the FAO did not issue its report on the billing system until November 17, 2011, one year and six months after the last tested transaction. The oldest tested transaction was nearly four years old. As such, the FAO's testing was untimely and not necessarily an accurate reflection of the current billing system. This is a repeated deficiency because GAO also noted in Report No. GAO-09-468, September 2009 (Page 99) that testing associated with the FAO's 2005 billing system audit of the same contractor was untimely and did not support the reported opinion.

Although the FAO restricted the reported audit opinion to the time period tested (December 2007 through May 2010), we question the usefulness of this opinion since the tested transactions were up to four years old. In accordance with DFARS 242.7502(c), the contracting officer, in consultation with the auditor or technical specialist, is responsible for determining the acceptability of the contractor's current accounting system (which includes the billing system), approving or disapproving it, and withholding a percentage of billings if significant deficiencies exist. Untimely reporting of deficiencies often precludes contracting officers from taking actions that might be necessary to protect the Government's interests until the contractor corrects system deficiencies.

Attachment 3 (cont'd)

As a result of the untimely testing, the FAO also did not have sufficient evidence to recommend contractor withholdings in this case. Therefore, the FAO should supplement the report to remove the recommendation for contractor withholdings.

We examined the factors which contributed to the untimely testing and noted that the FAO took one year and four months after testing to issue the report. While the auditor took only one month and 19 days to prepare the initial draft report, the FAO spent the remaining time (over one year and two months) performing several management/technical reviews, editing the report format, and incorporating the contractor's response. GAO noted that the same FAO took two years to issue the 2005 report after completion of testing.

In DOD Inspector General Report No. D-2011-6-011, September 21, 2011, we substantiated an allegation that DCAA had no written agency-wide policy or guidance regarding the need to perform testing of "current" data to support an opinion of a contractor business system. We recommended that DCAA Headquarters develop agency-wide policy and guidance on the need to test current data to support such opinions. In response, DCAA issued Memorandum For Regional Director 12-PAS-012(R), April 24, 2012, emphasizing in part that timely reporting is essential and that every effort should be made to plan and perform the audit and issue the audit report within a timeframe which avoids the elapse of excessive time between the tested transactions and the report date. Since January 2012, DCAA Headquarters has required that auditors use a milestone plan to assist them in this effort.

Due to the repeated instances of untimely reporting, DCAA should perform a detailed review of the San Diego FAO's report preparation and review processes to ensure compliance with current DCAA policy and make any other improvements necessary to reduce the cycle time between completion of testing procedures and report issuance.

Recommendations

1. We recommend that the Director, Defense Contract Audit Agency:
 - a. Develop policy and guidance on the tailoring of audit steps and approaches to auditing a business system while a contractor transitions from one system to another.
 - b. Perform a review of the report preparation and review processes employed at the San Diego field audit office to ensure compliance with current DCAA policy and to make any other improvements necessary to reduce the cycle time between completion of testing procedures and report issuance.
2. We recommend that the Director, Defense Contract Audit Agency direct the Regional Director, DCAA Western Region, to supplement Audit Report No 4551-2009B11010001 in order to remove the recommendation for withholding a percentage of contractor payments.

Attachment 3 (cont'd)

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the factual matters discussed in this memorandum in advance of the draft report.

We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED]
[REDACTED] or [REDACTED]



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 4



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

August 2, 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY MID-ATLANTIC REGION

SUBJECT: Results of High Risk Review Regarding Audit Assignment No. 6421-2011B19200007 (APO HRR Memorandum No. 4, Project No. D2012-DIP0AI-0013.000)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 6421-2011B19200007, involving a reported Cost Accounting Standard (CAS) 403 noncompliance. Our review of the assignment disclosed no exceptions.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). Our fourth selection under this high-risk review effort was DCAA Assignment No. 6421-2011B19200007.

In Audit Report No. 6421-2011B19200007, December 27, 2011, a field audit office (FAO) in Chantilly, Virginia, reported a CAS 403 noncompliance associated with a major DOD contractor's inequitable allocation of recruiting costs to final cost objectives. The FAO recommended that the contractor change its method for allocating recruiting costs in order to comply with CAS 403. The FAO initially found the reported CAS 403 noncompliance during its examination of a forward pricing rate proposal, under Assignment No. 6421-2011B23000002.

Objective and Scope of High-Risk Review

We reviewed Assignment No. 6421-2011B19200007 to determine if the FAO:

- correctly applied appropriate criteria such as the Federal Acquisition Regulations, DFARS, and Cost Accounting Standards;
- followed key Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and

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Attachment 4 (cont'd)

- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package and reviewed other relevant documents. We did not perform a comprehensive review of Assignment No. 6421-2011B19200007 for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of Assignment No. 6421-2011B19200007 disclosed no exceptions with the criteria applied, procedures followed, evidence gathered, or findings and recommendations reported.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] at [REDACTED] or [REDACTED].


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 5



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
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OCT 04 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Results of DoD OIG High Risk Review – DCAA Audit Report No. 6341-2011D21000009, (APO HRR-PP Memorandum No. 5)

This memorandum sets forth the results of our oversight review of DCAA Audit Report No. 6341-2011D21000009 *Independent Audit of [REDACTED] Fixed Price Proposal for [REDACTED]*. The report was issued by the Southern New Jersey Branch Office on November 22, 2011. The oversight review is being performed under DoD OIG Project No. D2012-DIP0A1-0013.

Our oversight review disclosed:

- DCAA did not evaluate the adequacy of the [REDACTED] cost or pricing data supporting the proposed direct labor hours (Finding A).
- DCAA did not perform sufficient work to determine the need to request the assistance of a technical specialist (Finding B).
- DCAA did not examine the proposed labor hours for compliance with FAR Part 31 and Cost Accounting Standards (CAS) (Finding C).
- DCAA did not compare proposed material cost with documents describing individual transactions entered in [REDACTED] ledgers and journals (Finding D).
- DCAA did not compare proposed material cost with documentary evidence created by an "arm's length" party (Finding E).
- DCAA incorrectly qualified the audit report for technical assistance (Finding F), and
- DCAA did not perform sufficient audit procedures to report on proposed labor hours (Finding G).

The resulting contract action should be audited for contractor compliance with the Truth in Negotiations Act (TINA) and compliance with FAR Part 31 Contract Cost Principles and Procedures and the requirements and procedures in 48 CFR Chapter 99, Cost Accounting Standards. The Southern New Jersey Branch Office should perform training and establish and implement procedures to provide reasonable assurance that pricing proposal audits are performed in accordance with existing DCAA audit policy.

Background

We selected DCAA Assignment No. 6341-2011D21000009 for oversight review as part of our responsibility to perform oversight of DCAA audits.

Attachment 5 (cont'd)

On June 20, 2011, the Army Contracting Command – Redstone, requested field pricing support from DCMA, to include all applicable audits. On July 20, 2011, the Defense Contract Management Agency (DCMA) [REDACTED] Philadelphia office requested DCAA audit the June 15, 2011 [REDACTED] Multiyear Bridge Proposal and Foreign Military Sale [REDACTED] fixed price proposal for 14 new [REDACTED] aircraft with a proposed price of \$369,475,127, as follows:

Summary, [REDACTED] proposal for [REDACTED] Aircraft

Cost Elements	Proposed Cost
Direct Labor Hours ¹	658,813
Direct Labor	\$48,196,950
Direct Material	\$167,492,845
Interdivisional Work Authorizations	\$27,636,489
Other Costs	\$780,555
Overhead	\$32,876,101
General & Administrative	\$21,813,609
Business Leadership	\$479,349
Facilities Capital Cost of Money	\$1,232,154
[REDACTED] Tooling Rqmts	\$8,467,120
Total Proposed Cost	\$308,975,175
Offset	\$9,707,821
Profit	\$50,792,134
Total Proposed Price	\$369,475,127

Objective and Scope of High Risk Review

The purpose of our oversight review is to evaluate whether the DCAA audit case file documentation (audit working papers) demonstrate that DCAA:

- Determined the adequacy of contractor cost or pricing data;
- Evaluated the contractor's proposal for compliance with FAR, CAS and existing DCAA policy; and
- Performed work sufficient to support the audit opinion on the acceptability of the contractor's cost or proposed costs for negotiation of a fair and reasonable price.

Results of High Risk Review

¹ The direct labor hours proposed by [REDACTED] included 149,557 engineering labor hours, 463,969 manufacturing labor hours and 45,288 miscellaneous and other labor hours.

Attachment 5 (cont'd)

Finding A. DCAA did not evaluate the adequacy of the cost or pricing data supporting the proposed direct labor hours

The [REDACTED] June 13, 2011 proposal for 14 new [REDACTED] aircraft included 463,969 manufacturing hours and 149,557 engineering hours.

The cost analysis techniques published at FAR 15.404-1(c)(2) include techniques the Government may use to ensure a fair and reasonable price. FAR 15.404-1(c)(2)(v) provides in part for a "Review to determine whether any cost data or pricing data, necessary to make the offeror's proposal suitable for negotiation, have not been either submitted or identified in writing by the offeror."

DCAA audit policy at DCAM 9-204a provides that the auditor shall evaluate the proposal to determine the adequacy of the certified cost or pricing data for audit purposes. DCAM 9-204b provides that the auditor should use professional judgment when deciding whether all reasonably available data has been submitted or identified to the auditor at the time of the proposal audit.

[REDACTED] estimated its proposed labor hours using an improvement curve and used historical labor cost accounting data as the basis for its improvement curve technique. [REDACTED] used the results of its improvement curve analysis as the basis for estimating other proposed labor hours and also used cost estimating relationships to estimate labor hours. The [REDACTED] cost estimating relationships were also based upon historical labor cost accounting data.

The DCAA audit working papers² demonstrate that DCAA:

- Incorrectly concluded that the [REDACTED] basis of estimates for labor hours with detailed rationale were not applicable to the proposal³.
- Marked as completed an audit step for evaluating [REDACTED] historical labor data for compliance with FAR Part 31 and CAS without referencing a working paper where applicable audit procedures had been performed. Instead DCAA referenced the contractor's own proposal and 'Engineer Analysis' without further explanation.
- Summarized the results of audit of 463,969 proposed manufacturing hours and 149,557 proposed engineering hours with a working paper that states only that DCAA requested a 'government technical review of direct labor hours.'

The DCAA audit working papers⁴ do not demonstrate that DCAA determined compliance with FAR 15.404-1(c)(2)(v) and DCAA audit policy.

² The only audit procedure demonstrated in the audit working papers is a verification that the proposed manufacturing and engineering labor hours reconciled with similar amounts in the [REDACTED] proposal information system.

³ DCAA reviewed the [REDACTED] proposal for adequacy on August 8, 2011. Although [REDACTED] had provided Basis of Estimates (BOEs) with detailed rationale to support the estimates for proposed labor hours, DCAA, in its assessment of proposal adequacy, determined this information "not applicable" to the proposal.

⁴ Defense Contract Audit Manual (DCAM), Chapter 4-400, Section 4 - *Audit Working Papers* paragraph 4-401 states that "The preparation of working papers assists the auditor in accomplishing the objectives of an audit assignment and serve as the principle support for the conclusions in the audit report. They also provide a record of the work performed; record of communications with the contractor and/or Government personnel; evidence of

Attachment 5 (cont'd)

Recommendation A

1. By January 31, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of FAR 15.404-2(c)(2)(v) and DCAM 9-204 *Determining Adequacy of Certified Cost or Pricing Data*.
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements FAR 15.404-1(c)(2)(v) and the audit guidance in DCAM 9-204 when performing price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Branch Manager, Southern New Jersey Branch Office, should perform a DCAA defective pricing audit on the contract action resulting from the negotiation of the [REDACTED] Multiyear [REDACTED] Proposal and Foreign Military Sale [REDACTED] to ensure that the negotiated contract price was not increased because the contractor did not submit or disclose accurate, complete and current certified cost or pricing data.
4. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items A.1 through 3, above, and document the results of such oversight on a quarterly basis until corrected.

Finding B. DCAA did not perform sufficient work to determine the need to request the assistance of a technical specialist

DCAA did not comply with the audit guidance provided in the DCAA Contract Audit Manual (DCAM) Appendix D *Technical Specialist Assistance*⁵ when it requested DCMA technical assistance in its audit of the labor hours included in the [REDACTED] June 15, 2011 fixed price proposal for 14 new [REDACTED] aircraft.

[REDACTED] estimated its proposed labor hours using an improvement curve and used historical labor cost accounting data as the basis for its improvement curve technique. [REDACTED] used the results of its improvement curve analysis as the basis for estimating other proposed labor hours and also used cost estimating relationships to estimate labor hours. The [REDACTED] cost estimating relationships were also based upon historical labor cost accounting data.

adequate supervision, are used as supporting data during negotiations, appeals, and litigations; and provide a basis for any other quality assurance reviews.”

⁵ The DCAA Contract Audit Manual (DCAM) Appendix D *Technical Specialist Assistance*, Section D-001 *Scope* provides audit guidance to assist the auditor “in (1) deciding if technical specialist assistance is needed, (2) identifying the specific type of assistance needed, (3) requesting the assistance, (4) achieving good communications with technical specialists, (5) assessing the impact of technical specialist findings upon the audit opinion, and (6) reporting on the use of technical specialists or the impact of their non-availability.” The DCAM is available on DCAA website at <http://www.dcaa.mil/> under Publications.

On June 27, 2011, the DCMA price/cost analyst initiated a technical review of the contractor's proposed labor hours. On July 21, 2011, the DCMA auditor was advised by the DCMA price/cost analyst that the DCMA technical team would be performing a technical review of the proposed labor hours. On September 8, 2011 DCMA acknowledged the DCMA request for audit assistance and advised DCMA "...that we need technical assistance to help us review the reasonableness of the proposed direct labor hours and quantities of direct materials."

DCMA 12-201 provides that "Requests for technical assistance should be very specific to avoid miscommunications and improve the probability of obtaining meaningful evaluations." "The DCMA audit working papers do not demonstrate that DCMA complied with the DCMA Contract Audit Manual (DCAM) Appendix D *Technical Specialist Assistance* as follows:

- DCMA did not perform tests of the underlying historical labor cost accounting data provided to and used by the specialist, as required by DCAM 12-101d.
- DCMA did not perform tests to determine that the labor estimating techniques proposed by [REDACTED] to estimate labor hours, including the improvement curve and cost estimating relationships, were appropriate under the circumstances, as required by DCAM 12-102, i.e., "These tests include:
 - ascertaining the reliability and accuracy of the historical data,
 - evaluating the historical data to ensure it is representative and contains all costs that are purported to be there,
 - making sure the data is current, and
 - drawing a conclusion regarding the suitability of historical data for making estimates.
- The DCMA request for technical assistance did not include specific questions corresponding to individual audit steps to be performed, and did not address each element of the contractor's proposal for which the auditor could not make an independent assessment, as required by DCAM 12-205c.

The DCMA working papers do not demonstrate which specific labor estimating techniques DCMA determined it could not evaluate without technical assistance, and what aspect of such techniques DCMA required technical assistance with in order to determine cost reasonableness.

On inquiry, DCMA advised the OIG that:

"It is the standing practice at [REDACTED] Philadelphia to have all technical evaluations performed by the resident DCMA engineering team. These reviews can be accomplished on their own or in conjunction with the technical specialist assigned to the major buying commands. As such, DCMA is well versed on the procedures and guidance used by the DCMA engineering team and when available has incorporated the results of these technical reviews in our audit reports."

The DCMA engineer who performed the technical analysis advised the OIG that he had not spoken with DCMA regarding this proposal and that he had not discussed with DCMA what information DCMA needed from his technical analysis. He also stated that DCMA had not provided him with any information regarding the acceptability of the labor accounting data or

Attachment 5 (cont'd)

techniques used by [REDACTED] as a basis of the estimated labor hours. He explained that he had not evaluated the acceptability of the historical labor cost data used by [REDACTED] as a basis to estimate for the proposed manufacturing or engineering labor hours. He also explained that that it is not the role of the government engineer to evaluate the acceptability of contractor historical cost accounting data used to support contractor basis of estimates.

Recommendation B

1. By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM Appendix D *Technical Specialist Assistance*. The training should cover:
 - a. Specific guidance requiring the auditor make appropriate tests of accounting data provided to and used by the specialists as identified at DCAM D-101d,
 - b. Specific guidance regarding the actions the auditor should take where it is found the contractor has used a labor estimating technique that is based on historical data as identified at DCAM D-102.1c, and
 - c. Specific guidance regarding the actions the auditor should take in determining whether a contractor labor estimating technique based upon the use of historical data is appropriate as identified at DCAM D-205c,
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the audit guidance in DCAM Appendix D *Technical Specialist Assistance* when performing price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office to ensure DCAA correctly implements the audit guidance in DCAM Appendix D *Technical Specialist Assistance* and document the results of such oversight on a quarterly basis until corrected.

Finding C. DCAA did not examine the proposed labor hours for compliance with FAR Part 31 and CAS

The DCAA audit working papers do not demonstrate that DCAA evaluated the [REDACTED] proposed direct labor hours for compliance with FAR Part 31 and CAS as provided by FAR 15.404-1(c)(2)(iv) and DCAA audit policy.

FAR 15.404-1 (c) (2) (iv) requires:

Verification that the offeror's cost submissions are in accordance with the contract cost principles in part 31 and, when applicable,

Attachment 5 (cont'd)

the requirements and procedures in 48 CFR Chapter 99 (Appendix to the FAR loose leaf edition), Cost Accounting Standards.

In addition to the cost principles identified in Part 31, [REDACTED] is subject to Public Law 100-679 (41 U.S.C. 422) which requires that they comply with the Cost Accounting Standards (CAS) and disclose in writing and follow consistently their cost accounting practices⁶. Accordingly, [REDACTED] is required to disclose their method of charging each direct labor category (Manufacturing Labor, Engineering Labor and Other Direct) to Federal contracts⁷ and for complying with all CAS specified in 48 CFR 9904 in effect at the date of contract award⁸. For instance, CAS 401 - *Consistency in estimating, accumulating and reporting costs*⁹ requires that a contractor's practices used in estimating costs for a proposal are consistent with cost accounting practices used by him in accumulating and reporting costs. Also CAS 402 - *Consistency in allocating costs incurred for the same purpose*¹⁰ requires that each estimate of cost to be incurred is allocated only once and on only one basis to any contract or other cost objective. Where it is found that a contractor has not complied with an applicable cost accounting standard or followed any cost accounting practice consistently and such failure results in any increased costs paid the United States, FAR 52.230-2 - *Cost Accounting Standards* provides that the contractor shall agree to an adjustment of the contract price or cost allowance, as appropriate.

DCAM 8-304 *Audit of Estimated, Accumulated, and Reported Costs to Ascertain Compliance with CAS and FAR* provides that the DCAA auditor is responsible for conducting audits to ascertain whether the contractor's actual cost accounting practices comply with CAS and FAR Part 31¹¹. It also provides that auditors are expected to be knowledgeable of compliance requirements and consider them as applicable in examination of contract proposals.¹²

The DCAA Standard Audit Program for performing price proposal audits provides procedures for auditing direct labor hours that include testing proposed direct labor hours for compliance with FAR Part 31 and CAS¹³.

The DCAA audit working papers do not demonstrate that DCAA examined the [REDACTED] proposal and determined that [REDACTED] had complied with the requirements of FAR Part 31 and the requirements and procedures in 48 CFR Chapter 99 (Appendix to the FAR loose leaf edition), Cost Accounting Standards. Specifically, the audit working papers do not demonstrate that DCAA evaluated the proposed 463,969 manufacturing hours and 149,557 engineering hours to determine that the hours were classified consistent with [REDACTED] established and disclosed accounting practices for direct labor and complied with the requirements of CAS 401 and CAS 402. Likewise, the audit working papers do not demonstrate that DCAA evaluated the historical labor hour data used by [REDACTED] to support its labor hour estimating techniques and

⁶ 48 CFR 9903.101 Cost Accounting Standards.

⁷ See CASB Form DS-1 Item No. 2.5.0 available at www.whitehouse.gov/ondprocurement/cash_ds_1.pdf.

⁸ 48 CFR 9903.201-2(a) Full Coverage

⁹ 48 CFR 9904.401

¹⁰ 48 CFR 9904.402

¹¹ DCAM 8-304.1a Requirements.

¹² DCAM 8-304.2a Compliance Audits.

¹³ DCAA Standard Audit Program, activity code 21000, Audit Program for Price Proposal, available at <http://www.dcaa.mil>.

Attachment 5 (cont'd)

determined such historical labor hour data is in reasonable compliance with [REDACTED] disclosed accounting practices and CAS 401 and CAS 402.

Recommendation C

1. By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of FAR 15.404-2(c)(2)(iv) and DCAM 3-304 *Audit of Estimated, Accumulated, and Reported Costs to Ascertain Compliance with CAS and FAR*.
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements FAR 15.404-2(c)(2)(iv) and the audit guidance in DCAM 3-304 when performing price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Branch Manager, Southern New Jersey Branch Office, should perform a DCAA CAS compliance audit on the [REDACTED] Multiyear [REDACTED] Proposal and Foreign Military Sale [REDACTED] and determine that the [REDACTED] proposal was submitted in compliance with its established and disclosed accounting practices as well as FAR Part 31 and CAS 401 and CAS 402.
4. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion of the actions identified in items C.1 through 3 above, and document the results of such oversight on a quarterly basis until corrected.

Finding D. DCAA did not compare proposed material cost with documents describing individual transactions entered in [REDACTED] ledgers and journals.

DCAA did not comply with DCAA policy at DCAM 3-104.14e when they audited [REDACTED] proposed material costs. The [REDACTED] June 15, 2011 proposal to the U.S. Government included proposed material costs totaling \$167,492,845. Of this amount, [REDACTED] disclosed it had previous purchase history for parts valued at \$15,741,973¹². Comparing documentary evidence supporting the purchase history contained in [REDACTED] ledgers and journals to proposed costs for parts in this proposal could have ensured [REDACTED] proposed material costs were fair and reasonable.

When examining audit evidence developed by the contractor, DCAM 3-104.14e provides guidance on the use of contractor ledgers and journals:

¹² [REDACTED] uses various methods to estimate proposed material. Among the methods used in this proposal were purchase contracts, long term agreements, firm quotes, commercial pricing, multi-year options, and previous purchase history.

Attachment 5 (cont'd)

"To express an opinion on the contractor's representations of incurred costs, the auditor should have evidence that the:

- (1) Costs claimed are supported by entries in the ledger accounts;
- (2) Account totals correctly summarize the detailed entries; and
- (3) Entries in the accounts represent a proper accounting interpretation of transactions.

The chain of evidence extends from documents describing individual transactions through the books of original entry to ledger accounts and to the cost representations."

The DCAA audit working papers do not demonstrate that DCAA complied with DCAM 3-104.14e and determined that the costs contained in [REDACTED] ledgers and journals represented a proper accounting interpretation of transactions by examining documents describing individual transactions. Instead, the DCAA audit working papers demonstrate DCAA compared [REDACTED] proposed prices to [REDACTED] ledgers and journals without further examination. The additional step of comparing entries in the contractor's ledgers and journals with documentary evidence of transactions such as vendor invoices could have ensured [REDACTED] proposed material costs were fair and reasonable.

Recommendation D

1. By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM 3-104.14e.
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 3-104.14e when performing price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items D.1 and 2, above, and document the results of such oversight on a quarterly basis until corrected.

Finding E. DCAA did not compare proposed material cost with documentary evidence created by an "arm's length" party.

DCAA did not comply with DCAA policy at DCAM 3-104.13 *Types and Flow of Transactions* when they audited [REDACTED] proposed material costs. The [REDACTED] June 15, 2011 proposal to the U.S. Government included proposed material costs of \$167,492,845. Of this amount, [REDACTED] provided in its basis of estimate that it had negotiated multiyear options for material costs estimated at \$51,285,650.

Attachment 5 (cont'd)

DCAA policy DCAM 3-104.13 provides that, for transactions that are generated externally such as materials, the audit scope is often limited to verification to documentary evidence created by an "arm's length" party (for instance, vendor invoices submitted by a material supplier) that substantiates the costs¹⁵.

The DCAA audit working papers do not demonstrate that DCAA complied with DCAA policy at DCAM 3-104.13 and compared the [REDACTED] proposed prices for negotiated multiyear options with documentary evidence created by an "arm's length" third party. Instead, the DCAA audit working papers demonstrate DCAA compared [REDACTED] proposed prices to [REDACTED] internally generated documentation consisting of agreements for future shipments. The additional step of comparing [REDACTED] internally generated documentation with evidence from an "arm's length" party, such as the vendor with which [REDACTED] made the agreement, could have ensured [REDACTED] proposed material costs were fair and reasonable.

Recommendation F

1. By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on DCAA policy at DCAM 3-104.13.
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 3-104.13 when performing price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items D.1 through 3, above, and document the results of such oversight on a quarterly basis until corrected.

Finding F. DCAA incorrectly qualified the audit report for technical assistance

On November 22, 2011, DCAA issued Audit Report No. 6341-2011021000009 providing the results of their audit to the contracting officer. DCAA qualified their audit report opinion because they had not received the requested technical assistance report from the DCMA technical specialist. DCAA reported that:

"During the course of our examination, technical assistance was deemed necessary to determine the reasonableness of the proposed direct labor hours and kinds and quantities of direct material. We were unable to reach a definitive conclusion about the acceptability of the proposed costs by other available

¹⁵ The July 2007 revision of Generally Accepted Government Auditing Standard (GAGAS) 6.41 requires auditors to obtain sufficient appropriate evidence, such as confirmation from outside parties. GAGAS can be found on the GAO website at <http://www.gao.gov/products/GAO-07-731G>.

Attachment 5 (cont'd)

engagement procedures. The results of the technical report are considered essential to the conclusion of this audit.”

The audit working papers demonstrate that DCAA chose not to perform other available audit procedures to evaluate the acceptability of proposed direct labor hours. As described in Findings A, B, and C, above:

- DCAA did not evaluate the adequacy of the cost or pricing data supporting [REDACTED] proposed direct labor hours;
- DCAA did not perform sufficient work to determine the need to request the assistance of a technical specialist; and
- DCAA did not examine the proposed labor hours for compliance with FAR Part 31 and CAS.

DCAM 10-210.4 *Qualifications*¹⁶ provides DCAA audit policy on the use of qualifications in DCAA audit reports. The audit guidance is for use when the auditor, having performed his or her audit, has concluded that (i) there is a lack of sufficient competent evidential matter on the part of the contractor, and/or (ii) there are restrictions in the scope of the audit examination that have led the auditor to conclude that he or she cannot express an unqualified opinion.

A finding by DCAA that [REDACTED] lacked sufficient competent evidential matter to support their proposed labor hours is not supported by documentation included in the DCAA audit working papers. Therefore lack of sufficient competent evidential matter cannot be used as a basis to qualify the report.

Regarding the existence of a restriction, DCAM 10-204e provides that a restriction on the scope of audit, whether imposed by the requestor, the contractor, or by circumstances, may require the auditor to qualify a report. DCAM 10-204.4e specifically states that:

The decision to qualify ... an opinion because of a scope limitation depends on an assessment of the importance of the omitted procedure(s) to the auditor's ability to form an opinion on the subject matter under audit.

The working papers do not demonstrate that an audit restriction was imposed by the requestor or by the contractor. However, the working papers do demonstrate that DCAA unilaterally omitted performing required audit procedures (see Finding B) necessary to determine whether technical assistance was required to assist the auditor in forming an opinion on the fairness and reasonableness of the proposed labor hours. In this case the ‘circumstance’ for qualifying the report was created by DCAA and could have been resolved by DCAA through a properly executed audit.

Recommendation F

¹⁶ DCAM 10-210.4 *Qualifications* paragraph b provides that a qualified opinion is expressed when: (1) there is lack of sufficient competent evidential matter or there are restrictions in the scope of the examination that have led the auditor to conclude that he or she cannot express an unqualified opinion and/or (2) the auditor believes, on the basis of the audit, that the subject matter under audit contains a departure from established criteria [i.e., FAR and CAS], the effect of which is material, and the auditor has concluded not to express an adverse opinion.

Attachment 5 (cont'd)

1. January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM 10-210.4 *Qualifications*.
2. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 10-210.4 *Qualifications* when reporting on the results of price proposal audits at the DCAA [REDACTED] location.
3. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion of the actions identified in items E.1 and E.2, above, and document the results of such oversight on a quarterly basis until corrected.

Finding G. DCAA did not perform sufficient audit procedures to report on proposed labor hours

On June 20, 2011, the Army contracting officer at the Army Contracting Command – Redstone, in accordance with FAR 15.404-1(a)(5) requested field pricing support from DCMA, to include all applicable audits. On July 20, 2011, the DCMA contract price/cost analyst at the DCMA [REDACTED] Philadelphia contract management office requested DCAA conduct a full audit of the [REDACTED] proposal, to cover [REDACTED] “labor and material costs and any other areas that you would consider beneficial for the negotiation of a fair and reasonable price.” On September 8, 2011, DCAA responded to DCMA that it had established an audit assignment and would perform audit procedures to “respond to all specifically requested items in your request package.”

The DCAA audit working papers which are not made available to the contracting officer or DCMA demonstrate that DCAA did not perform audit procedures to evaluate the acceptability of proposed direct labor hours. As described in Findings A, B, and C, above:

- DCAA did not evaluate the adequacy of the cost or pricing data supporting [REDACTED] proposed direct labor hours.
- DCAA did not perform sufficient work to determine the need to request the assistance of a technical specialist, and
- DCAA did not examine the proposed labor hours for compliance with FAR Part 31 and CAS.

Aside from the audit qualification for technical assistance addressed in Finding E, above, DCAA Audit Report No. 6341-2011D21000009 did not provide specific advice to the contracting officer regarding the [REDACTED] proposed manufacturing and engineering labor hours. DCAA did not report any inadequacies in the cost or pricing data supporting the proposed labor hours. DCAA did not report that the proposed labor hours were not in compliance with the applicable Cost Accounting Standards and appropriate provisions of FAR Part 31. A reader of DCAA Audit Report No. 6341-2011D21000009 can fairly and incorrectly conclude that DCAA

Attachment 5 (cont'd)

examined the [REDACTED] cost or pricing data supporting the proposed labor hours and found it adequate and compliant with the applicable CAS and appropriate provisions of FAR Part 31.

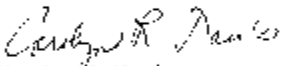
Recommendation C

1. The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure that audit reports to be issued on contractor price proposals at the DCAA [REDACTED] Philadelphia location are supported by sufficient competent audit evidence.
2. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion of the actions identified in items F.1. above, and document the results of such oversight on a quarterly basis until corrected.

Concluding Remarks

We do not require a formal written response from DCAA at this time. We plan to issue a formal draft report covering the results of multiple high-risk oversight reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on factual matters discussed in this memorandum in advance of the draft report.

If you have any questions, please contact the undersigned or [REDACTED] at [REDACTED] or by e-mail at [REDACTED].


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

cc:
Assistant Director of Integrity and Quality Assurance
Regional Director, Mid-Atlantic Region
Regional Audit Manager (RAMG-6), Mid-Atlantic Region
Branch Manager, South New Jersey Branch Office

Attachment 6



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

December 18, 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
NORTHEASTERN REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 2701-
2006A10100002 (APO HRR Memorandum No. 6, Project No. D2012-DIP0AI-
0013.000)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 2701-2006A10100002, involving DCAA Bay States Branch Office's audit of an incurred cost submission of a major DOD contractor. We recommend that the field audit office (FAO) supplement the audit report to include required audit qualifications, complete Mandatory Annual Audit Requirement (MAAR) No. 5, and obtain sufficient audit evidence related to consultant costs. In addition, the FAO should assess and document its consideration of potential irregularities and report the matter in a Form 2000 if warranted. These and other noted deficiencies are discussed in the Results of High Risk Review section below.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 2701-2006A10100002 as part of this high risk review effort.

Under Assignment No. 2701-2006A10100002, the DCAA Bay States Branch Office examined the 2006 incurred cost submission of a major DOD contractor. The purpose of the examination was to determine allowability of direct and indirect costs and recommend contracting officer-determined indirect cost rates for the period January 1, 2006 through December 31, 2006. On February 29, 2012, the DCAA Bay States Branch Office issued Audit Report No. 2701-2006A10100002, questioning the following costs:

~~FOR OFFICIAL USE ONLY~~

Attachment 6 (cont'd)

Cost Element	Proposed Cost	Questioned Cost
Direct Costs	\$346,732,718	
Subcontract costs		\$11,227,228
Indirect Costs	\$ 61,606,462	
DCAA allocation intercompany assist audits		\$(411,183)
Direct costs claimed as indirect expenses		<u>328,217</u>
Net Indirect Cost Questioned		\$(82,966)
Allocation Base	\$375,422,109	
General & Administrative Expense		\$(1,561,382)

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the FAO:

- correctly applied appropriate criteria such as the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards;
- followed key Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, interviewed appropriate DCAA employees, and reviewed other relevant documents. We did not perform a comprehensive review of Assignment No. 2701-2006A10100002 for compliance with all generally accepted government auditing standards (GAGAS).

Results of High-Risk Review

Our review of Assignment No. 2701-2006A10100002 disclosed exceptions with the criteria applied, procedures followed, evidence gathered, and findings and recommendations reported. Details of the exceptions are as follows:

Audit Planning

1. The auditor did not document an understanding of internal controls that are material to the subject matter in order to plan the engagement and design procedures to achieve the objectives of the attestation engagement, as required by:

Attachment 6 (cont'd)

- GAGAS 6.10, Internal Control;
- DCAA Contract Audit Manual (CAM) 2-306, Internal Controls; and
- DCAA CAM 5-101, 5-102, 5-103.1d, Obtaining and Understanding of a Contractor's Internal Controls and Assessing Control Risk.

Since the contractor implemented a new Enterprise Resource Planning (ERP) system (including a new accounting system) on January 1, 2006 that had not been reviewed, the auditor could no longer rely on the results of prior reviews as a basis for obtaining an understanding of the internal controls. Although the auditor set control risk at maximum and increased testing to mitigate risk of loss to the government, the auditor should have still documented an understanding of the key processes and applicable policies and procedures related to the cost areas being evaluated.

Because the audit covers 2006 incurred costs, it might not be practical for the FAO to develop and document an understanding of the contractor's internal controls that were in effect six years ago. However, the FAO needs to emphasize to the audit staff the requirement for documenting the relevant internal controls in current and future audits.

2. The auditor did not perform MAAR 5, which requires that the auditor review the complete set of internal financial statements, such as the general ledger and trial balance. The auditor considered the expense statement only. The complete general ledger was not evaluated for other income or credits that could potentially result in decreased costs to the Government. Examples of these other income or credits include purchase discounts, sale of scrap, royalty income, and capitalized losses. MAAR 5, Miscellaneous Income and Credits, states in part:

The auditor should evaluate the contractor's internal financial statements, to include the general ledger, trial balance and other subsidiary ledgers to identify any income or credits in which the Government should share as well as to evaluate the exclusion of any adjustments not reflected by the contractor in contract costs.

Therefore, to effectively perform MAAR 5, the auditor should examine the complete general ledger, trial balance and other subsidiary ledgers to identify any income or credits which the Government should share, and evaluate the exclusion of any adjustments not reflected by the contractor in claimed contract costs.

Reported Scope of Audit

Under the scope of audit section of the report, the internal control system paragraph indicates that the contractor's accounting system is adequate for accumulating, reporting, and billing costs on Government contracts. The FAO had no basis for making this statement because the contractor implemented a new accounting system that the FAO had not reviewed. The statement should be consistent with the paragraph addressing the accounting system included in the Contractor's Organization and Systems section of the report, which states:

Attachment 6 (cont'd)

Effective January 1, 2006 [*the contractor*] has implemented a new Oracle Enterprise Resource Planning (ERP) system. The implementation affects virtually all accounting and internal control systems by replacing the majority of their legacy systems. We have not yet performed examinations of the company's Labor System, Accounting System and Billing System to determine if the new implemented systems can be relied upon to produce reliable cost data. Until such time as those audits are complete, our audits will include expanded testing of cost data to provide a reasonable basis for our opinion. (*contractor name omitted*)

Reported Qualifications

1. In accordance with DCAA CAM 10-210.4 and 10.504.4, Qualifications, the report requires a qualification for the \$4.5 million in unresolved cost allocated from a related company that is considered material to the subject matter. The FAO should supplement the report to add this qualification.
2. In accordance with DCAA CAM 10-504.5b, Results of Audit, the direct cost opinion paragraph requires an "except for" qualification statement related to the \$47.9 million in unresolved direct cost. The FAO should supplement the report to add the "except for" qualification.
3. The first qualification statement relating to unresolved assist audit subcontract cost states, "These assist audit results do not impact the indirect expense rates of the prime contractor for this fiscal year." This statement is inaccurate since any adjustment to the final direct subcontract cost could impact the rates that include subcontract costs in the allocation base. For this contractor, the impacted rates would include the Procurement, General & Administrative expense, and Cost of Money rates. In addition, the assist audit results could impact the calculation of penalties since subcontract costs are included in the base for determining applicable penalties. Therefore, the FAO should supplement the report to remove this qualification.

Field Work

1. In Exhibit A (G&A), Note 6 and Exhibit G (Penalties), the auditor incorrectly identified and applied a penalty to an unreasonable training cost which is not specifically unallowable under FAR 31.205 and is therefore not subject to a penalty. Accordingly, the FAO should supplement the report to remove the penalties applied to unreasonable training costs.
2. The auditor accepted the claimed cost for Professional Service Cost of a consultant based solely on the review of a consulting agreement. The working papers do not include sufficient audit evidence to support this conclusion. GAGAS 7.55 – 7.71 and DCAA CAM 2-506, Obtaining Sufficient, Appropriate Audit Evidence, requires auditors to obtain sufficient, appropriate audit evidence to provide a reasonable basis for their findings and conclusions. The working papers do not support that the auditor adequately considered the specific documentation requirements of FAR 31.205-33(f), Professional and Consultant Service Costs. FAR 31.205-33(f) states in part:

...fees for services rendered are allowable only when supported by evidence of the nature and scope of the service furnished. Evidence

Attachment 6 (cont'd)

necessary to determine that work performed is proper and does not violate law or regulation shall include details of all agreements, invoices to include details as to the nature and timing of work and the consultant's work product to include related documents, trip reports and collateral information.

Therefore, to conclusively determine the allowability of the consultant costs, the auditor needs to perform additional field work to examine the consultant invoices, work product, related trip reports and any other documentation necessary to support the nature and scope of the services rendered.

Reporting

1. The auditor questioned direct costs in excess of \$11 million, which represents the entire direct cost claimed under Subcontract Agreement No. S-2789. In Exhibit F, Note 1, the auditor discusses eight strong indicators of potential irregular activity for which the issuance of a Form 2000 should be considered as recommended by GAGAS and DCAA policy.

GAGAS 6.33, Reporting Deficiencies in Internal Control, Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements and Abuse, states:

For attestation engagements, auditors should report, as applicable to the objectives of the engagement, and based upon the work performed, (1) significant deficiencies in internal control, identifying those considered to be material weaknesses; (2) all instances of fraud and illegal acts unless inconsequential; and (3) violations of provisions of contracts or grant agreements and abuse that could have a material effect on the subject matter of the engagement.

DCAM 2-404(c), Reporting Deficiencies in Internal Controls, Fraud, Illegal Acts, Violations of Provisions of Contracts, states:

...when fraud or suspected irregularities are discovered, DCAA should issue a Form 2000 instead of including the matter in a report. Therefore, the auditor should document the consideration of the above circumstances as a suspected irregular activity and report the matter if warranted (preferably using a Form 2000).

2. In Appendix 2, the auditor included a Schedule of Claimed Direct Cost by Contract which serves no useful purpose. Moreover, the use of this schedule may result in unintended consequences because it does not identify significant unresolved and questioned costs, including \$47,858,158 in unresolved costs, \$11,227,728 in questioned costs, and \$1,489,307 in expressly unallowable intercompany profits. Accordingly, the FAO should supplement the report to remove this schedule.

Recommendations

We recommend that the Director, Defense Contract Audit Agency direct the Northeastern Regional Director to:


Attachment 6 (cont'd)

1. Advise the contracting officer that the FAO will supplement the report to correct several reported errors and omissions.
2. Perform a review of MAAR 5 to identify any other income or credits which the Government might be entitled to receive.
3. Re-examine claimed consultant costs, ensuring that the auditor adequately considers the specific documentation requirements for consultant costs contained in FAR 31.205-33(f).
4. Prepare and issue a supplemental report in accordance with DCAA CAM 10-214 to:
 - a. correct the reported qualifications;
 - b. revise the recommended penalties;
 - c. remove the Schedule of Claimed Direct Cost by Contract; and if necessary
 - d. incorporate the results of performing the MAAR 5 and re-examining claimed consultant costs (discussed in Recommendations 2 and 3 above).
5. Provide training to Bay States Branch Office Auditors for:
 - a. developing and documenting an understanding of internal controls;
 - b. completing MAAR 5, including the potential cost reductions resulting from an adequate review of the contractor's internal financial statements, to include the general ledger, trial balance and other subsidiary ledgers;
 - c. incorporating appropriate report qualifications; and
 - d. obtaining sufficient, appropriate audit evidence to provide a reasonable basis for the findings and conclusions on the allowability of consultant costs.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the matters discussed in this memorandum in advance of the draft report.

We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED]


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 6-A



NORTHEASTERN REGION
DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
59 LOWES WAY, SUITE 300
LOWELL, MASSACHUSETTS 01851-5150

IN REPLY REFER TO:
RD-2 225.2.B

May 13, 2013

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY
AND OVERSIGHT, DEPARTMENT OF DEFENSE, 4800 MARK CENTER
DRIVE, ALEXANDRIA, VIRGINIA 22350-1500

ATTENTION: Carolyn R. Davis, Assistant Inspector General

SUBJECT: Response to Inspector General (IG) December 18, 2012 Memorandum on the
Results of High Risk Review (HRR) Regarding DCAA Audit Assignment No.
2701-2006A10100002

REFERENCE: APO HRR Memorandum No. 6, Project No. D2012-DIP0AI-0013.000

The referenced APO Memorandum transmitted the results of the Inspector General's High Risk Review regarding DCAA Audit Assignment No. 2701-2006A10100002. This memorandum documents the corrective actions taken by the Field Audit Office (FAO) in response to the cited recommendations in the referenced memorandum. The cited recommendations and our responses are as follows:

1. IG Recommendation:

Advise the Contracting Officer that the FAO will supplement the report to correct several reported errors and omissions.

1. DCAA Response:

The FAO notified [REDACTED], DCMA Divisional Administrative Contracting Officer (DACO), in Memorandum No. 2013-005 (See Enclosure 1) dated January 29, 2013, that a supplemental audit report would be issued to address the issues identified by the IG.

2. IG Recommendation:

Perform a review of MAAR 5 to identify any other income or credits which the Government might be entitled to receive.

2. DCAA Response:

The FAO performed additional audit steps relative to MAAR 5 to identify any other income or credits which the Government might be entitled to receive. See Note 11 of Exhibit A

Attachment 6-A (cont'd)

RD-2 225.2.B

May 13, 2013

SUBJECT: Response to Inspector General (IG) December 18, 2012 Memorandum on the Results of High Risk Review (HRR) Regarding DCAA Audit Assignment No. 2701–2006A10100002

(Page 17) of Audit Report No. 2701–2006A10100002–S1 (See Enclosure 2), dated April 30, 2013, for the audit results.

3. IG Recommendation:

Re-examine claimed consultant costs, ensuring that the auditor adequately considers the specific documentation requirements for consultant costs contained in FAR 31.205-33(f).

3. DCAA Response:

The FAO performed additional audit steps relative to claimed consultant costs to determine allowability pursuant to FAR 31.205-33(f). See Note 15 of Exhibit A (Page 21) of Audit Report No. 2701–2006A10100002–S1 (See Enclosure 2) dated April 30, 2013, for the audit results.

4. IG Recommendation:

Prepare and issue a supplemental report in accordance with DCAA CAM 10-214 to:

- a. correct the reported qualifications;
- b. revise the recommended penalties;
- c. remove the Schedule of Claimed Direct Cost by Contract; and if necessary
- d. incorporate the results of performing the MAAR 5 and re-examining claimed consultant costs (discussed in Recommendations 2. and 3. above).

4. DCAA Response:

The FAO issued Supplemental Audit Report 02701-2006A10100002-S1 (See Enclosure 2) dated April 30, 2013 to [REDACTED], DCMA DACO, in accordance with DCAA CAM 10-214 that address the IG's recommendations as follows:

- a. included a qualification related to \$4.5 million in unresolved [REDACTED] allocation costs (See Note 4 on Page 4 of Enclosure 2); we also included the "except for" language in our results section to reference the qualification for the \$47.9 million unresolved direct costs (See Page 5 of Enclosure 2);
- b. revised the recommended penalties to correct Exhibit A, Note 6 (Page 12 of Enclosure 2) to remove the penalty recommendation on unreasonable training costs and revised Exhibit G, Penalty Schedule (Page 48 of Enclosure 2) accordingly;
- c. replaced the Schedule of Claimed Direct Cost by Contract with the Schedule of Government Cost-Reimbursement and Flexibly Priced Contracts and Subcontracts (See Appendix 2 of Page 54 of Enclosure 2) to exclude dollar values associated with the schedule of contracts; and
- d. incorporated the results of our expanded audit steps related to MAAR 5 (See Page 17 of Enclosure 2) and claimed consultant costs (See Page 21 of Enclosure 2) as discussed in Responses 2. and 3. above.

Attachment 6-A (cont'd)

RD-2 225.2.B

May 13, 2013

SUBJECT: Response to Inspector General (IG) December 18, 2012 Memorandum on the Results of High Risk Review (HRR) Regarding DCAA Audit Assignment No. 2701-2006A10100002

5. IG Recommendation:

Provide training to Bay States Branch Office auditors for:

- a. developing and documenting and understanding of internal controls;
- b. completing MAAR 5, including the potential cost reductions resulting from an adequate review of the contractor's internal financial statements, to include the general ledger, trial balance, and other subsidiary ledgers;
- c. incorporating appropriate report qualifications; and
- d. obtaining sufficient, appropriate audit evidence to provide a reasonable basis for the findings and conclusions on the allowability of consultant costs.

5. DCAA Response:

The FAO provided training on all four recommended areas for the Bay States Branch Office auditors on April 3rd and 4th of 2013 (See Page 4 of Enclosure 3).

Questions regarding this memorandum should be directed to the undersigned at (978) 551-9710.

Ronald C. Meldonian

Ronald C. Meldonian
Regional Director

Enclosures, 3

1. Supplemental Notification Memorandum 2013-005



2013-005 Memo For
[REDACTED] DACO.doc

2. Supplemental Audit Report 02701-2006A10100002-S1



01 DCAA Report
02701-2006A1010000

3. Bay States Branch Office Quality Training Minutes



2013-133.docx

Copy furnished:

HQs, QQ [REDACTED]

DRD-2

RAMC-2

FAO 2701 [REDACTED]

Attachment 7



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22304-1500

DEC 19 2012

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY WESTERN REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 4201-2012L11070001 (APO HRR Memorandum No. 7, Project No. D2012-DIP0AI-0013,000)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 4201-2012L11070001, involving DCAA Pacific Branch Office's audit report on the contractor's noncompliance with Defense Federal Acquisition Regulation Supplement (DFARS) 252.242-7006, Accounting System Administration. Our review of the assignment disclosed no significant exceptions.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 4201-2012L11070001 as part of this high risk review effort.

Under Audit Report No. 4201-2012L11070001, the DCAA Pacific Branch Office cited the contractor for noncompliance with DFARS 252.242-7006 due to significant deficiencies in time keeping, accumulating, and allocating labor costs. The FAO found the deficiencies during an examination of the contractor's timekeeping system performed under Assignment No. 4201-2010L17740004, and reported the findings in Audit Report No. 4201-2012L11070001.

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the FAO:

- correctly applied appropriate criteria such as the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards;
- followed key Agency procedures and guidance; and
- gathered sufficient evidence in support of the reported findings and recommendations; and issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

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Attachment 7 (cont'd)

To accomplish the objective, we obtained and reviewed a copy of the assignment working paper package, interviewed appropriate DCAA employees and the cognizant contracting officer, and reviewed other relevant documents. We did not perform a comprehensive review of Assignment No. 4201-2012L11070001 for compliance with all generally accepted government auditing standards (GAGAS).

Results of High-Risk Review

Our review of Assignment No. 4201-2012L11070001 disclosed no significant exceptions with the criteria applied, procedures followed, evidence gathered, or findings and recommendations reported.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED]

or [REDACTED]



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 8



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

January 24, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
WESTERN REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 4411-2005X10100017 (APO HRR Memorandum No. 8 (Project No. D2012-DIP0AI-0013.000))

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 4411-2005X10100017, involving an audit of a DoD contractor's claimed incurred cost for 2005. Our review of the audit assignment disclosed that the auditor did not:

- complete all mandatory annual audit requirements;
- perform tests on audit criteria cited in the report; and
- review the contractor's IRS Forms 941.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 4411-2005X10100017 as part of this effort.

Under Assignment No. 4411-2005X10100017, the field audit office (FAO) examined the contractor's June 30, 2006 certified final corporate home allocation proposal and related books and records for reimbursement of 2005 incurred costs. The FAO performed the examination to determine the allowability, allocability, and reasonableness of claimed corporate allocations totaling \$158 million and fringe benefit costs of \$172 million. On January 30, 2012, the FAO issued audit report 4411-2005X10100017, questioning \$20,786,742 of claimed corporate allocations.

Objective and Scope of High-Risk Review

We reviewed Assignment No. 4411-2005X10100017 to determine if the FAO:

- correctly applied appropriate criteria such as the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards (CAS);
- followed key agency procedures and guidance;

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Attachment 8 (cont'd)

- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, conducted face-to-face interviews of appropriate DCAA employees, and reviewed other relevant documents. We did not perform a comprehensive review of Assignment No. 4411-2005X10100017 for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of Assignment No. 4411-2005X10100017 disclosed that the FAO did not perform sufficient tests in support of the reported findings. We found that the FAO: (1) did not perform all Mandatory Annual Audit Requirements; (2) cited criteria in the audit report that was not tested; and (3) did not review the contractor's IRS forms 941.

DCAA Mandatory Annual Audit Requirements

Our review disclosed that the FAO did not complete DCAA Mandatory Annual Audit Requirements (MAARs) 6, 10, and 15 as required by the DCAA Contract Audit Manual (CAM), section 6-105, and the DCAA incurred cost audit program.

MAAR 6 (floor checks) - The auditor told us she does not perform MAAR 6 at this contractor location because the contractor's employees charge all labor as indirect. We do not agree with the auditor's explanation. The FAO should have accomplished this MAAR on a concurrent basis to test the reliability of employee time records, ensure employees are actually at work and performing in assigned job classifications, and the time is charged to the proper cost objective. The need to accomplish MAAR 6 was particularly important since the FAO did not audit the contractor's labor accounting system, complete other labor related MAARs, or accomplish all audit program steps related to labor cost. For 2005, in lieu of a concurrent floor check, the FAO must perform labor transaction testing to verify the reliability of claimed labor costs (as instructed in audit program section D-1, step 8). If the labor transaction testing results in additional questioned cost, the FAO should supplement the audit report. In the future, the FAO needs to begin performing concurrent floor checks at this contractor location.

MAAR 10 (adjusting journal entries) - The auditor should have performed MAAR 10 in order to review labor and indirect adjusting journal entries, and identify adjustments that require further audit analysis and explanation. In working paper 14 (MAAR Control Log) of the subject assignment, the auditor stated that this MAAR is not applicable because the incurred cost review relates to a corporate office. Although this contractor location is a corporate office with no direct government contracts, it can still use adjusting journal entries to manipulate cost allocated to government contracts at the division level. The FAO needs to obtain a listing of adjusting journal entries and select a sample of them to identify any adjustment that requires further audit analysis. If the audit analysis results in additional cost, the FAO should supplement the audit report.

Attachment 8 (cont'd)

MAAR 15 (indirect cost comparison) - The FAO should have performed MAAR 15 which compares claimed indirect pool and base costs to respective budgetary data to identify significant variances requiring further review. In the working papers, the auditor stated "Comparison to prior year(s) cost deemed most effective method. Time consumption for budget comparison not deemed warranted." This statement does not adequately explain why the auditor omitted MAAR 15. When limiting the comparison to prior years, the auditor might not be identifying all variances that require further review. For example, a comparison to budgetary data could disclose accruals that were not adjusted to actual cost at year-end. Therefore, DCAA should perform a budgetary cost comparison and review any significant variances. If the review of significant variances results in additional questioned cost, the FAO must supplement the audit report.

Cited Criteria not Used During the Audit

The Scope of Audit section of Audit Report No. 4411-2005X10100017 indicates that the auditor used the Department of Energy Acquisition Regulation Supplement as one of the criteria to evaluate the contractor's 2005 incurred cost proposal. However, we found no evidence in the working papers that the auditor used this criteria to evaluate the proposal. CAM 10-210.3(d) Scope of Audit, states that the scope paragraph should identify the established or stated criteria used to evaluate the proposal, submission, or system. The FAO needs to determine whether it should expand testing of the proposal to incorporate the Department of Energy Acquisition Regulation Supplement criteria and supplement the report, if necessary.

Required Review of IRS Form 941 Not Completed

The auditor did not examine the contractor's IRS Forms 941 as required by audit program section D-1, step 4a. The auditor should review these forms to verify the accuracy of the contractor's claimed labor cost and payroll taxes. If the verification results in additional questioned cost, the FAO must supplement the audit report.

Recommendations

We recommend that the Director, Defense Contract Audit Agency, direct the Western Regional Director to:

1. Advise the contracting officer that:
 - a. the report should not be used for any purpose because the FAO did not perform sufficient tests in order to provide a reasonable basis for its opinion; and
 - b. the FAO will supplement the report, as necessary, to reflect the results of the additional tests.
2. Begin performing MAAR 6 on a concurrent basis at the contractor facility. For contractor fiscal years where MAAR 6 was not performed concurrently, conduct labor transaction testing to verify the reliability of claimed labor costs.


Attachment 8 (cont'd)

3. Perform a review of MAAR 10 to identify indirect adjusting journal entries which require additional review.
4. Perform a review of MAAR 15 to identify and review cost elements which show a material variance from the contractor budgetary data.
5. Determine if the auditor should expand testing of the proposal to incorporate the Department of Energy Acquisition Regulation Supplement criteria.
6. Reconcile IRS Forms 941 to the contractor's claimed labor and payroll taxes.
7. Prepare and issue supplemental audit report in accordance with DCAA CAM 10-214, as necessary, to incorporate the results of Recommendations 2 through 6.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the factual matters discussed in this memorandum in advance of the draft report.

We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED]

 [REDACTED]
Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 9



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

April 1, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
WESTERN REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 4151-2005T10100004 (APO HRR Memorandum No. 9)
(Project No. D2013-DAPOCF-0004.002)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 4151-2005T10100004, involving an audit of a DoD contractor's claimed incurred costs for 2005. Our review of the audit assignment disclosed that the auditor:

- understated recommended penalties by \$54,207;
- did not maintain supporting documentation for the reported penalty participation rate as required by FAR 42.709-2(b)(2); and
- failed to question unallowable bonus costs and related adjustments.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 4151-2005T10100004 as part of this effort.

Under the assignment, the field audit office (FAO) examined the contractor's January 14, 2008, certified final indirect cost proposal and related books and records for reimbursement of 2005 incurred costs. The FAO performed the examination to determine the allowability, allocability, and reasonableness of claimed direct and indirect cost totaling \$33 million. On October 3, 2012, the FAO issued its audit report, questioning \$751,855 of claimed indirect costs.

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the FAO:

- correctly applied appropriate criteria, such as the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and contract terms;

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Attachment 9 (cont'd)

- followed key agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, made inquiries to FAO personnel, and reviewed other relevant documents. We did not perform a comprehensive review of the assignment for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of Assignment No. 4151-2005T10100004 disclosed the following:

Penalty Assessment on Home Office Flow-Down

Our review disclosed that the FAO under-stated recommended penalties on questioned home office flow-down cost¹. The FAO received DCAA Report No. 4151– 2005A10100003, which questioned \$91,877 in home office flow-down costs that were subject to penalty. However, the schedule of recommended penalties contained in DCAA Report No. 4151-2005T10100004 did not include the \$91,877 as subject to penalties, which caused an understatement of \$54,207 in recommended penalties based on a Government participation rate of 59 percent ($\$91,877 \times 59 \text{ percent} = \$54,207$). The FAO did not comply with the DCAA Contract Audit Manual 6-609(b)(3), requiring that the receiving FAO report home office flow-down costs subject to penalties. The FAO should supplement the report to include the additional \$91,877 in questioned cost subject to penalty and \$54,207 in recommended penalties.

Other Penalty Errors

The FAO made the following three additional errors associated with the calculation of penalties:

- Incorrectly calculated government penalty participation rates;
- Incorrectly allocated questioned penalty cost within the contractor's combined fringe benefit pool; and
- Failed to assess penalties on questioned cost due to questioned rates within the contractor's indirect pools.

We discussed these errors in greater detail with the FAO personnel who conducted the audit. We are not requesting that the FAO supplement the report to correct them because, in this

¹ Home office flow-down costs are costs accumulated at the contractor's corporate or intermediate "home office" and subsequently allocated down to its reporting segments or divisions.

Attachment 9 (cont'd)

case, the errors did not result in significant differences. However, the FAO should be provided with training on the proper calculation and reporting of penalties in the near future.

Unsupported Penalty Computations

The working papers did not include any support for how the FAO computed its reported penalty participation rates. The FAO attempted to recreate the computations after advising us that it was unable to locate the original computation. However, the recreated computation did not tie to the reported rate. In accordance with FAR 42.709-2(b)(2), the auditor must maintain rationale and supporting documentation in the working paper file for any recommendations related to penalties. The FAO should be provided training on maintaining the appropriate level of support for its recommended penalty assessments in the working papers.

Incorrect Bonus Cost Adjustment

Within the contractor's FY 2005 incurred cost claim, we noted that the contractor made two downward adjustments of \$21,500 each to the fringe benefits and on-site overhead bases. According to the FAO, the contractor made the adjustments in an attempt to reverse a FY 2004 error of claiming unallowable bonus costs on Contract No. DRTA01-03-D-0003, Delivery Order 12. However, the adjustments actually had the effect of overcharging the Government for indirect costs in FY 2005, and failing to reimburse the Government for the unallowable bonus costs claimed in FY 2004. The FAO did not question the FY 2005 downward adjustments or the FY 2004 claimed unallowable bonus costs. The FAO should supplement Audit Report No. 4151-2005T10100004 to question the downward adjustments of \$21,500 each, and supplement Audit Report No. 4151-2004T10100004 to recommend disallowance of the unallowable bonus cost. In addition, the FAO should reflect these recommended changes in the FYs 2004 and 2005 Cumulative Allowable Cost Worksheets.

Recommendations

We recommend that the Director, Defense Contract Audit Agency, direct the Western Regional Director to:

1. Advise the contracting officer that the FAO must:
 - a. supplement Audit Report No. 4151-2005T10100004 to adjust recommended penalties and other questioned bonus costs; and
 - b. supplement prior year Audit Report No. 4151-2004T10100004 to recommend disallowance of unallowable bonus costs on Contract DRTA01-03-D-0003.
2. In accordance with DCAA Contract Audit Manual 10-214, instruct the FAO to supplement:
 - a. Audit Report No. 4151-2005T10100004 to: (1) reflect the additional \$91,877 in questioned cost subject to penalties and \$54,196 in additional recommended penalty assessments, (2) question the two \$21,500 bonus

Attachment 9 (cont'd)

adjustments, and (3) make appropriate adjustments to the Cumulative Allowable Cost Worksheet; and

- b. Audit Report No. 4151-2004T10100004 to: (1) question \$21,500 in unallowable direct bonus costs on Contract No. DTRA01-03-D-0003, Delivery Order 12; and (2) revise the Cumulative Allowable Cost Worksheet to reflect the questioned bonus cost plus applicable indirect costs.

3. Provide training to the FAO auditors on how to properly calculate and document recommended penalties.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the factual matters discussed in this memorandum in advance of the draft report.

We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED]


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 10



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22304-1500

April 2, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Results of High Risk Review-Forward Pricing (HRR-FP) Regarding DCAA Audit Report No. 2701-2012C21000001 (APO HRR-FP Memorandum No. 10)

This memorandum sets forth the results of our oversight review of DCAA Audit Report No. 2701-2012C21000001 *Independent Audit of* [REDACTED]

Proposal. The report was issued by the DCAA Bay States Branch Office on March 23, 2012. The subject of the audit was a firm fixed price subcontract price proposal included in a prime contract proposal submitted to the U.S. Government by the [REDACTED] Company. The oversight review is performed under DoD OIG Project No D2012-DIP0AI-0013.

We selected DCAA Assignment No. 2701-2012C21000001 as part of our responsibility to perform oversight of DCAA audits.

Our oversight review disclosed:

- DCAA audited an inadequate subcontract proposal. (Finding A)
- DCAA Bay States Branch Office did not align their audit scope and depth with the needs of the contracting officer thereby significantly diminishing the usefulness of the report. (Finding B)
- The DCAA Bay States Branch Office did not incorporate the results of a requested technical evaluation into their audit report. (Finding C)

In accordance with DCAA audit policy, the Bay States Branch Office audited an inadequate [REDACTED] Systems subcontractor proposal. DCAM 9-205d discourages reviews of clearly inadequate contract proposals; however, DCAM provides that if a contracting officer maintains their request for audit despite significant proposal deficiencies, the auditor will perform the audit but advise the contracting officer that under the circumstances the audit report should not be used as a basis for negotiation. Additionally, DCAA did not align the scope and depth of its subcontract proposal audit to reflect the minimum essential supplementary information needed by the DoD Joint Strike Fighter Program Office (Program Office) contracting officer to conduct a cost analysis of the [REDACTED] acquisition. As a result of the misalignment, the Program Office did not need or use DCAA Audit Report No. 2701-2012C21000001 to establish a pre-negotiation position.

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Attachment 10 (cont'd)

DCAA Bay States Branch Office expended 1,481 audit hours on the audit of the [REDACTED] Systems subcontract proposal. In total, DCAA field audit offices expended 8,803 audit hours auditing seven inadequate subcontract proposals (including [REDACTED] Systems) in support of the [REDACTED] acquisition. The Program Office did not need the seven subcontract audit reports to complete its cost analysis and establish its pre-negotiation position on November 30, 2011.

Objective and Scope of High Risk Review

The purpose of our oversight review is to evaluate whether the DCAA audit case file documentation (audit working papers) demonstrates that DCAA:

- Determined the adequacy of contractor cost or pricing data;
- Evaluated the contractor's proposal for compliance with FAR, CAS and existing DCAA policy; and
- Performed work sufficient to support the audit opinion on the acceptability of the contractor's cost or proposed costs for negotiation of a fair and reasonable price.

Background

On March 31, 2011, the contracting officer requested the DCAA Ft. Worth Resident Office (DCAA Ft. Worth) provide "full scope audit assistance" on the [REDACTED] fixed price incentive fee/cost plus incentive fee contract proposal. The \$4.5 billion prime contract proposal dated April 25, 2011 was for the purchase of 32 aircraft. The request for proposal had been amended on January 13, 2011 to reduce the quantity of aircraft to be procured from 42 to 32. The Program Office advised DCAA Ft. Worth, the DCAA field audit office performing the prime contract audit, that it was "willing and open to discuss realistic, creative solutions to the generation and transmission of audit data to seek the greatest benefit to the Government."

DCAA Ft. Worth determined the proposal to be adequate for audit on May 20, 2011.

On August 25, 2011, DCAA Ft. Worth requested the DCAA Bay States Branch Office perform an assist audit of the [REDACTED] fixed-price subcontract proposal [REDACTED] Systems). DCAA Ft. Worth requested the DCAA Bay States Branch Office provide their audit report by November 30, 2011.

The attachment to this memorandum provides a chronology of significant events surrounding the contracting officer's request for audit, subsequent determinations by DCAA of proposal adequacy and inadequacy, and the March 23, 2012 DCAA Bay States Branch Office audit report on an inadequate proposal.

Attachment 10 (cont'd)

Results of High Risk Review

Finding A – DCAA audited an inadequate subcontract proposal

On September 14, 2011, the Bay States Branch Office evaluated the September 1, 2011 [REDACTED] Systems firm-fixed price subcontract proposal to determine if the contractor had submitted an adequate proposal in accordance with FAR 15.408 Table 15-2. The proposal was priced at \$188,309,894 for 42 ship-sets and \$163,896,983 for 32 ship-sets.

On September 19, 2011 the DCAA Bay States Branch Office notified DCAA Ft. Worth by memorandum that they were unable to perform an audit of the [REDACTED] Systems subcontract proposal due to numerous inadequacies including:

- Lack of a consolidated bill of materials to support proposed material costs of \$77,866,155 for 42 ship-sets as required by FAR 15.408, Table 15-2 II.
- Failure to perform adequate cost and price analysis on 11 subcontract proposals totaling \$55,789,960. Each subcontract proposal was in excess of the threshold for submitting cost or pricing data as required by FAR 15.408, Table 15-2.
- Lack of cost or price analysis demonstrating that prices proposed for commercially priced items were fair and reasonable in accordance with FAR 15.404-3.
- The [REDACTED] Systems pricing model used to derive the 32 ship-set pricing from the 42 ship-set baseline used different factors and base amounts than those included in the [REDACTED] Systems certified proposal and resulted in different proposed amounts for both the 42 ship-sets and 32 ship-sets.

In accordance with DCAA audit policy at DCAM 9-205d¹, the DCAA Bay States Branch Office concluded the memorandum by stating that “If the contracting officer or DCAA Ft. Worth insists, the Bay States Branch will perform an audit of the subject proposal; however, an adverse opinion will be a certainty.”

DCAM 9-205d states in part that:

If the certified cost or pricing data are so deficient that an examination cannot be performed, the auditor should notify the contracting officer of the deficiencies and recommend that the contracting officer return the proposal to the contractor. However, if the contracting officer decides not to return the proposal and maintains the request for audit, the auditor should document the discussion and evaluate the proposal to the extent practical under the circumstances. Because the deficiencies are

¹ The DCAA Contract Audit Manual (DCAA Manual 7640.1) is an official publication of the Defense Contract Audit Agency (DCAA). It prescribes auditing policies and procedures and furnishes guidance in auditing techniques for personnel engaged in the performance of the DCAA mission.

Attachment 10 (cont'd)

significant, the report will advise the contracting officer that the proposal should not be used as a basis for negotiation until specified corrective actions are completed.

On September 26, 2011 DCAA Headquarters coordinated with the DCAA Bay States Branch Office and the Bay States Branch agreed to perform an audit on the inadequate proposal.

FAR 15.404-2(d) *Deficient proposals* provides in part that:

The ACO or the auditor, as appropriate, shall notify the contracting officer immediately if the data provided for review is so deficient as to preclude review or audit.

And

The contracting officer immediately shall take appropriate action to obtain the required data.

FAR 15.402 – Pricing Policy requires that contracting officers shall purchase supplies and services at fair and reasonable prices. When a contracting officer elects not to ‘take appropriate action to obtain the required data’ identified by the auditor to make a deficient proposal acceptable, it can undercut the effectiveness of the audit services requested. It can also incentivize a contractor to disregard the requirement in FAR 15.408 Table 15-2 to submit all accurate certified cost or pricing data. DCAA audit policy at DCAM 9-205d allowing the auditor perform an audit on an inadequate proposal does not ensure that taxpayer dollars are spent on fair and reasonable prices. In operation it can undermine the FAR requirement that a contractor submit to the U.S. Government an adequate proposal. It also results in the inefficient and ineffective use of limited DoD contract audit resources.

Recommendation A

By June 30, 2013, the Director, DCAA should evaluate DCAA audit policy, including that specified at DCAM 9-205d, and make the revisions necessary to provide reasonable assurance that:

1. DCAA audit policy does not result in DCAA performing audits on contractor and subcontractor proposals that DCAA auditors have determined are inadequate for audit.
2. DCAA audit policy will result in DCAA auditors performing contractor or subcontractor proposal audits only after the contracting officer has taken appropriate action and obtained the required data necessary to make the proposal adequate in accordance with FAR 15.408 Table 15-2.
3. DCAA audit policy provides for DCAA notifying the OIG of an unsatisfactory condition when a contracting officer has not taken the appropriate action to obtain the required data in accordance with FAR 15.404-2(d) *Deficient proposals*.

Attachment 10 (cont'd)

Finding B – DCAA Bay States Branch Office did not align their audit scope and depth with the needs of the contracting officer thereby significantly diminishing the usefulness of the report

In accordance with DCAA audit policy at DCAM 9-205d and at the direction of DCAA Headquarters, the DCAA Bay States Branch Office audited the [REDACTED] Systems subcontract proposal previously determined to be inadequate and issued Audit Report No. 2701–2012C21000001 [REDACTED]

[REDACTED] Proposal on March 23, 2012. DCAA reported that the [REDACTED] Systems subcontract proposal was not an acceptable basis for negotiation of a fair and reasonable price and that the cost or pricing data submitted by [REDACTED] Systems were not adequate. DCAA reported that to make the cost or pricing data adequate, [REDACTED] Systems needed to perform the following:

- Perform adequate cost and price analyses for subcontracts that exceed the cost or pricing data threshold.
- Perform adequate analyses to demonstrate the continuing reasonableness of long term agreements with subcontractors and material vendors.
- Perform commercial item determination (CID) and cost or price analysis to establish a fair and reasonable price in accordance with DFARS 244.402 and FAR 15.404-3.

Additionally, the audit report was untimely. It was issued 113 days after the Program Office had approved on November 30, 2011 their Pre-Negotiation Business Clearance Memorandum for negotiating the [REDACTED] contract.

FAR 15.404-1(a) provides that the contracting officer is responsible for evaluating the reasonableness of offered prices and that the analytical techniques and procedures described in FAR 15.404 – Proposal Analysis may be used, singly or in combination with others, to ensure that the final price is fair and reasonable. Additionally, FAR 15.404-2(a) provides that the contracting officer shall tailor requests for field pricing assistance to “...reflect the minimum essential supplementary information needed to conduct a technical or cost or pricing analysis.”

In January 2011, the Program Office elected not to require [REDACTED] to obtain revised subcontract proposals to reflect the reduction in aircraft procured from 42 to 32. Due to ‘enormous pressure to get [REDACTED] wrapped up by late summer/early fall’ the Program Office had determined that it would rely on [REDACTED] the prime contractor, to demonstrate in its subcontract price and cost analysis how it had adjusted proposed subcontract prices associated with 42 aircraft to the 32 aircraft requirement. The Program Office explained it could not achieve its negotiation schedule if it waited to begin DCAA subcontract audits until after updated subcontract proposals were received, reviewed and released by [REDACTED]

The Program Office Pre-Negotiation Business Clearance Memorandum established a government negotiation position of \$119,763,930 for the [REDACTED] Systems subcontract. The

Attachment 10 (cont'd)

Pre-Negotiation Business Clearance Memorandum position relied upon input from the Program Office Cost Analyst and considered the [REDACTED] Systems subcontract proposal, [REDACTED] price/cost analysis and technical analysis of the supplier.

The Pre-Negotiation Business Clearance Memorandum states that [REDACTED] proposed a price of \$133,803,402 for the [REDACTED] Systems subcontract and that [REDACTED] arrived at the price using variable pricing techniques. It further states [REDACTED] on July 20, 2011 revised its price/cost analysis to \$123,177,055 to account for a quantity reduction from 42 to 32 aircraft.

The Program Office Pre-Negotiation Business Clearance Memorandum addressed the DCAA September 19, 2011 notice of proposal inadequacy at [REDACTED] Systems. It justified the decision to proceed with negotiations as follows:

"The Government determined that the inadequacies found in DCAA's audit were not materially substantial to withhold negotiations with [REDACTED] [The [REDACTED] price and cost analysis] on this supplier and an independent Government analysis based on historical data and future projections is adequate to support a fair and reasonable position."

"The [Pre-Negotiation Business Clearance Memorandum] position relies on [Program Office] Cost Analyst input for this supplier. In developing its position, the Government reviewed and took into account the supplier's proposal and [REDACTED] price and cost analysis and technical analysis of the supplier."

"The Government agrees with the analysis performed in the [REDACTED] revised [price and cost analysis], but included additional challenges to CLINs 1001, 2001, and 3001 through an 86% learning curve applied to cost history."

"The Government agrees with the [price and cost analysis] evaluated profit rate of 12.04%. For comparative purposes, the [REDACTED] considered negotiated profit for this supplier was 12.85%."

The Program Office Pre-Negotiation Business Clearance Memorandum demonstrates a combination of analytical techniques and procedures used by the contracting officer to establish a fair and reasonable pre-negotiation position for the [REDACTED] Systems subcontract. Additionally, the Program Office advised DCAA Ft. Worth in January 2011 on its decision not to require [REDACTED] to obtain revised subcontract proposals and to use the [REDACTED] subcontract price and cost analysis to assist in achieving a fair and reasonable contract price.

FAR 15.404-2(c) *Audit assistance for prime contracts or subcontracts* provides at paragraph (3) that the auditor is responsible for the scope and depth of the audit. In this case the scope and depth of the audit established by DCAA included performing an audit of the [REDACTED] Systems subcontract proposal. This did not align with minimum essential supplementary information the Program Office needed to conduct a cost analysis to determine a fair and reasonable price on the [REDACTED] procurement.

Attachment 10 (cont'd)

Further review of the November 30, 2011 Program Office Pre-Negotiation Business Clearance Memorandum demonstrates that at the time the Program Office approved its pre-negotiation position, DCAA field audit offices had outstanding a total of seven subcontract audits (including [REDACTED] Systems) where DCAA had notified the contracting officer that the proposal was inadequate for audit. The seven subcontract proposal audits were as follows:

Subcontract Proposal	Subcontract Value	DCAA Audit Hours Expended
[REDACTED]	\$ 188,309,894	1,481
[REDACTED]	622,344,215	1,283
[REDACTED]	73,261,070	2,151
[REDACTED]	51,241,447	920
[REDACTED]	53,212,603	584
[REDACTED]	24,638,105	1,343
[REDACTED]	93,179,115	1,041
Total	\$1,106,186,449	8,803

As with the [REDACTED] Systems subcontract proposal, the Program Office Pre-Negotiation Business Clearance Memorandum demonstrates that the program office used a combination of analytical techniques and procedures to establish fair and reasonable pre-negotiation positions for these subcontract proposals and did not await issuance of the subcontract audit reports by DCAA.

Recommendation B

By June 30, 2013, the Director, DCAA, should evaluate DCAA audit policy and determine whether policy changes are needed to ensure that in planning the audit scope and depth of DCAA proposal audits, the auditor tailors his or her audit scope and depth to obtain the minimum essential information requested by the contracting officer while still complying with Government Auditing Standards.

Finding C – The DCAA Bay States Branch Office did not incorporate the results of a requested technical evaluation into their audit report

On November 3, 2011, the DCAA Bay States Branch office requested Defense Contract Management Agency (DCMA) perform a technical evaluation of proposed labor and material costs included in the [REDACTED] Systems subcontract proposal. The audit working papers demonstrate that the DCMA technical evaluation report was received on February 3, 2012, seven weeks before the date of the DCAA report. However, DCAA Bay States Branch Office in their March 23, 2012 audit report stated the technical evaluation report was received too late to be incorporated into their report. The DCAA Bay States Branch further determined that the late receipt constituted a limitation to the scope of the audit.

Attachment 10 (cont'd)

DCAA audit policy at DCAM Appendix D-302c provides that:

“It is the auditor’s responsibility to examine the technical evaluation report to ensure reasonable understanding of the actual work performed. The auditor’s working papers must document:

- (1) the auditor’s understanding of the actual work performed,
- (2) the degree of reliance the auditor placed on the technical evaluation, including its impact on the results of audit.”

After the auditor has examined the technical evaluation report and determined the degree of reliance, DCAAM Appendix D-302c also requires the auditor to “use the work of the specialist(s) unless findings are obviously unrealistic, or procedures used appear inadequate.” DCAAM Appendix D-302c (3) requires the auditor attach the report to the audit report as the final appendix.

The DCAA Bay States Branch Office had ample time to incorporate the results of the technical evaluation into Audit Report No. 2701–2012C21000001 but the audit working papers do not demonstrate that DCAA evaluated the results between the time the technical evaluation report was received and the time the DCAA audit report was issued. The audit working papers also do not indicate that a supplemental report including the technical evaluation was issued.

Recommendation C

1. By June 30, 2013, the Branch Manager, DCAA Bay States Branch Office, should provide the audit staff with training on the requirements of DCAAM Appendix D-300 Section 3, *Evaluation, Use and Impact of the Results of Government Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule*.
2. By April 30, 2013, the Branch Manager, DCAA Bay States Branch Office, should implement procedures that provide reasonable assurance that the audit staff has complied with the audit guidance in DCAM Appendix D *Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule* when performing price proposal audits and issuing price proposal audit reports.
3. The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Bay States Branch Office to ensure DCAA correctly implements the audit guidance in DCAM Appendix D-300 Section 3, *Evaluation, Use and Impact of the Results of Government Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule* and document the results of such oversight on a quarterly basis until corrected.

Attachment 10 (cont'd)

Concluding Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on factual matters discussed in this memorandum in advance of the draft report.

If you have any questions, please contact the undersigned or [REDACTED] at [REDACTED] [REDACTED]



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment:
As stated

Attachment 10 (cont'd)

Chronology of Significant Events

Results of High Risk Review-Forward Pricing (HRR-FP) Regarding DCAA Audit Report No. 2701-2012C21000001 (APO HRR-FP Memorandum No. 10)

September 29, 2010 – The DoD Joint Strike Fighter Program Office (Program Office) requested audit assistance from the DCAA Ft. Worth Resident Office (DCAA Ft. Worth) in anticipation of [REDACTED] Proposal, based on a quantity of 42 aircraft.

January 13, 2011 – The Program Office amended their request for proposal to reduce the quantity of aircraft from 42 to 32 due to “unforeseen circumstances.”

January 18, 2011 – A teleconference was held with Program Office, DCAA Ft. Worth, DCMA, and [REDACTED] representatives in attendance to discuss the [REDACTED] proposal update. For audits of subcontractor proposals, DCAA Ft. Worth preferred to wait for proposals for the revised quantity of 32 aircraft and then commence audits. The Program Office’s position was to not require revised proposals because that approach would add considerable time to the negotiation schedule.

January 19, 2011 – The contracting officer sent an e-mail to the Program Office Director of Contracts discussing the previous day’s teleconference and DCAA’s position. In the e-mail, the contracting officer stated, “While I understand [DCAA’s] concern, I do not believe that the program office, much less the SAEs [JSF Service Acquisition Executives] will support a slip in the negotiation schedule.”

January 21, 2011 - The Program Office advised DCAA Ft. Worth on its decision to not require [REDACTED] to obtain revised subcontract proposals to reflect the reduction in aircraft from 42 to 32. On that same day DCAA Ft. Worth had advised the Program Office that it was likely that the subcontractors probably would not support DCAA audits of their proposals until the subcontractors had completed updates, and that DCAA would likely be unable to audit the proposed subcontract costs until updates were provided.

March 31, 2011 – The Program Office requested DCAA Ft. Worth provide “full scope audit assistance” on the [REDACTED] proposal. The Program Office advised DCAA Ft. Worth that it was “willing and open to discuss realistic, creative solutions to the generation and transmission of audit data to seek the greatest benefit to the Government.”

April 25, 2011 – Date of [REDACTED] \$4.5 billion (Prime) fixed price incentive fee/cost plus incentive fee [REDACTED] contract proposal for 32 aircraft

April 26, 2011 - DCAA Ft. Worth received the [REDACTED] \$4.5 billion proposal.

May 20, 2011 – DCAA Ft. Worth determined the proposal to be adequate for audit. At that time DCAA Ft. Worth working papers demonstrate that [REDACTED] was awaiting receipt of

Attachment
Page 1 of 2

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Attachment 10 (cont'd)

37 subcontract proposals valued at \$1.7 billion and that [REDACTED] had not completed the required subcontract cost or price analysis in accordance with FAR 15.404-3(b). The [REDACTED] Systems subcontract proposal was included in the 37.

August 25, 2011 - DCAA Ft. Worth requested the DCAA Bay States Branch Office perform an assist audit of the [REDACTED] fixed-price subcontract proposal ([REDACTED] Systems). DCAA Ft. Worth requested the DCAA Bay States Branch Office provide their audit report by November 30, 2011.

September 1, 2011 - DCAA Bay States Branch Office received the [REDACTED] Systems subcontract proposal priced at \$188,309,894 for 42 ship-sets and \$163,896,983 for 32 ship-sets. The subcontract proposal included pricing for 32 ship-sets based on a baseline quantity of 42 ship-sets.

September 14, 2011 - DCAA Bay States Branch Office performed an adequacy review of the [REDACTED] subcontract proposal, and determined that the subcontract proposal was inadequate for audit.

September 19, 2011 - DCAA Bay States Branch Office notified DCAA Ft. Worth by memorandum that they were unable to perform an audit of the [REDACTED] subcontract proposal due to numerous inadequacies including a lack of a consolidated bill of material; [REDACTED] failure to perform adequate cost and price analyses for eleven subcontracts; the lack adequate of support for commercially priced items; and inconsistency between [REDACTED] proposal and their pricing model.

DCAA Bay States Branch concluded the memorandum by stating that "If the contracting officer or DCAA Ft. Worth insists, the Bay States Branch will perform an audit of the subject proposal; however, an adverse opinion will be a certainty."

September 26, 2011 - After a telephone discussion with DCAA Headquarters, the DCAA Bay State Branch Office agreed to provide an audit report on the [REDACTED] Systems subcontract proposal by January 17, 2012.

November 16, 2011 - DCAA Bay States Branch Office provided a memorandum as a non-audit service to DCAA Ft. Worth conveying limited information regarding the costs included in the [REDACTED] proposal. The DCAA Bay States Branch Office also advised DCAA Ft. Worth that they expected to issue an audit report on January 17, 2012 recommending the [REDACTED] Systems proposal not be used as a basis for negotiations.

November 30, 2011 - The Program Office approved their Pre-Negotiation Business Clearance Memorandum for negotiating the [REDACTED] contract.

March 23, 2012 - DCAA Bay States Branch Office issued Audit Report No. 2701-2012C21000001 *Independent Audit of [REDACTED] Proposal*. DCAA reported that the [REDACTED] Systems subcontract proposal they had examined was not an acceptable basis for negotiation of a fair and reasonable price, and that the cost or pricing data submitted by [REDACTED] Systems were not adequate.

Attachment
Page 2 of 2

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Attachment 11



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22304-1500

May 10, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Results of High Risk Review – Forward Pricing (HHR-FP) Regarding DCAA
Audit Report No. 4821–2011R21000012, (APO HRR-FP Memorandum No. 11)

This memorandum sets forth the results of our oversight review of DCAA Audit Report No. 4821–2011R21000012, *Independent Audit of Parts of a Proposal* [REDACTED]

[REDACTED] issued by the DCAA [REDACTED] Mesa Resident Office on February 3, 2012. The oversight review is being performed under DoD OIG Project No. D2012-DIP0AI-0013.

We selected DCAA Assignment No. 4821–2011R21000012 as a part of our responsibility to perform oversight of DCAA audits.

Our oversight review disclosed:

- DCAA Work papers do not document planning and interim discussions with the contracting officer (Finding A),
- DCAA provided the contracting officer with conflicting advice regarding the adequacy of the [REDACTED] proposal (Finding B),
- DCAA was untimely in notifying the contracting officer that they were not auditing the proposed indirect rates (Finding C),
- DCAA did not establish and maintain effective communications with the contracting officer in the audit of proposed labor hours (Finding D),
- The DCAA audit report did not meet the needs of the Contracting Officer (Finding E), and
- DCAA overstated dollars examined, questioned costs, and net savings reported in the DCAA Management Information System. (Finding F).

After expending 4,807 hours the DCAA Audit Report No. 4821–2011R21000012 did not meet the needs of the AMCOM contracting officer. The DCAA work papers do not establish that DCAA complied with existing DCAA policy and communicated effectively with the contracting officer. The AMCOM contracting officer had to expend additional DoD resources and convene a post-audit report issuance fact-finding summit to make the DCAA audit report useable for negotiating the contract. Additionally, amounts reported in the DCAA Management Information

¹ DCAA issued a revised audit report, DCAA Audit Report No. 4821–2011R21000012 (Revised) on February 7, 2012. Work paper 01a provides that "The report was reissued due formatting changes and page shifting that occurred during the conversion to a .pdf document."

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Attachment 11 (cont'd)

System for Audit Report No. 4821–2011R21000012 for dollars examined, questioned cost and net savings were corrected in some instances for significant overstatements and not corrected in others. Additionally, the final amount reported in DMIS for net savings, \$18.9 million, was not calculated in accordance with DMIS guidance.

Objective and Scope of High-Risk Review

The purpose of our oversight review is to evaluate whether the DCAA audit case file documentation (working papers) demonstrate that DCAA:

- Evaluated the contractor's proposal for compliance with FAR, CAS and existing DCAA policy,
- Determined the adequacy of contractor cost or pricing data, and
- Performed work sufficient to support the audit opinion on the acceptability of the contractor's proposed costs for negotiation of a fair and reasonable price.

Background

On September 1, 2011, the Army contracting officer at the Army Contracting Command – Redstone (AMCOM) requested that DCAA perform an audit of [REDACTED] Proposal No. [REDACTED] dated August 18, 2011 for [REDACTED] Proposal. The \$996.7 million firm-fixed price proposal was for the remanufacture of [REDACTED] and was priced as follows:

Summary [REDACTED] proposal for [REDACTED]

Cost Elements	Proposed Cost
Direct Labor Hours ²	2,476,999
Direct Labor	\$164,520,807
Direct Material	319,299,331
Interdivisional Work Authorizations	179,062,404
Other Direct Costs	29,382,952
Program Site Management & Other	1,476,739
Overhead	74,857,185
General & Administrative Expenses	63,592,806
Facilities Capital Cost of Money	2,201,648
Total Proposed Cost	\$834,393,872
Profit	\$162,277,483
Total Proposed Price	\$996,671,355

² The direct labor hours proposed by [REDACTED] included 741,149 touch labor hours, 211,337 non touch labor hours, 729,623 non-recurring labor hours, and 794,890 factored labor hours.

Attachment 11 (cont'd)

In accordance with FAR 15.404-2(a), the contracting officer requested that DCAA conduct an audit of the [REDACTED] proposal and any supporting data and prepare a report on the contractor's proposal. The contracting officer specifically identified the following areas for DCAA review³:

- “Validity of Section 1.5 Rates/Factors/Disclosures – request verification of, but not limited to, rates/factors/pricing methodology.
- Validity of Section 2 Cost Summaries – request verification of rates/factors/pricing methodology and facilities of cost of money.
- Validity of Section 3 – Bid Matrix – verification of recorded costs.
- Validity of Detail Substantiation – Section 5 – Material Volume \$319,299,331.
- Validity of Detail Substantiation – Section 6 – Other Direct Costs \$29,382,953 (Note on travel – the number of trips/people will be evaluated by [REDACTED] PM Technical).
- Validity of Detail Substantiation – Section 7 IWAs Volume - \$179, 062,404.
- Validity of Recorded Cost (Incurred Cost) – Section 8 (verify the recorded costs and also verify Appendix A – TINA Disclosures and Appendix I – Material Back-up).
- Verification of contractor's system review (purchasing, estimating, accounting system etc.) and Disclosure statements.”

The PCO excluded proposed direct labor hours from DCAA review. The PCO also requested that DCAA contact her ‘immediately’ should the DCAA audit field work identify any significant proposed costs that were unsupported. The PCO requested DCAA complete the audit by January 11, 2012. DCAA issued the report on February 3, 2012.

Results of High-Risk Review

Finding A. DCAA Work papers do not document planning and interim discussions with the contracting officer

FAR 15.404-2(a)(3) provides that when field pricing assistance is requested, contracting officers are encouraged to team with appropriate field experts throughout the acquisition process. It also provides that:

Early communication with these experts will assist in determining the extent of assistance required, the specific areas for which assistance is needed, a realistic review schedule, and the information necessary to perform the review.

On September 9, 2010, DCAA issued memorandum 10-PAS-024(R)⁴ subject: Audit Guidance on Auditor Communications. The audit guidance provided in part that:

³ For some cost elements, the contracting officer identified the specific value of proposed dollars included in the [REDACTED] proposal. For other cost elements the contracting officer did not specify specific proposed amounts.

Attachment 11 (cont'd)

- Effective communication with the contracting officer throughout the audit process is an essential part of performing a Generally Accepted Government Auditing Standards (GAGAS) compliant audit while meeting the requestor's needs.
- Auditors must communicate with the contracting officer to gain a clear understanding of the requestor's needs and specific concerns that he or she may have relative to the audit.
- Auditors should keep the contracting officer informed on the status of the audit as well as issues and problems arising during the course of the audit. and
- Auditor communications with the contracting officer should be appropriately documented in the working papers.

The DCAA working papers for audit assignment number 4821–2011R21000012 do not demonstrate that the auditors complied with DCAA audit policy and communicated with the AMCOM contracting officer to gain a clear understanding of her needs and any specific concerns that she had relative to the audit. Nor do they demonstrate that the auditors kept the contracting officer informed on the status of the audit as well as issues and problems arising during the course of the audit. In fact, the administrative working papers included in section 07, Government Notes/Correspondence⁵ do not document the results of any discussions and/or communications held with the AMCOM contracting officer.

With regard to working papers, DCAA audit policy at DCAM 4-401 provides in part the following:

The preparation of working papers assists the auditor in accomplishing the objectives of an audit assignment and serve as the principle support for the conclusions in the audit report. They also provide a record of the work performed; record of communications with the contractor and/or Government personnel; evidence of adequate supervision; are used as supporting data during negotiations, appeals, and litigations; and provide a basis for any other quality assurance reviews.

For audit assignment number 4821–2011R21000012, the DCAA working papers do not provide a basis to demonstrate that the auditors (i) communicated with the contracting officer in accordance with DCAA audit policy or (ii) teamed with the contracting officer in accordance with FAR 15.404-2(a)(3).

⁴ The audit guidance included in 10-PAS-024(R) was subsequently incorporated into the DCAM and the DCAA standard audit program for performing price proposal audits.

⁵ DCAM Figure 4-4-2 provides that the contents of administrative work paper section 07 are for "Government Notes / Correspondence."

Attachment 11 (cont'd)

Recommendation A

The Resident Auditor, DCAA [REDACTED] Resident Office, should:

1. Provide the audit staff with training on Audit Guidance on Auditor Communications, including the applicable sections of DCAM and the DCAA standard audit program for price proposal audits.
2. Provide the audit staff with training on the use of administrative working papers to document discussions and communications with the contracting officer in planning and performing the audit, including the use of working paper section 07, Government Notes/Correspondence.

Finding B. DCAA provided the contracting officer with conflicting advice regarding the adequacy of the [REDACTED] proposal

FAR 15.408 Table 15-2 provides contractors a format for submission of cost or pricing data when certified cost or pricing data are required by the contracting officer in accordance with FAR 15.403-4 – Requiring Certified Cost or Pricing Data (10 U.S.C. 2306a and 41 U.S.C. 254b).

DCAA audit policy at DCAM 9-103.1b states that contractor proposals should be evaluated for adequacy⁶ as soon as possible after receipt so that corrective action can be taken immediately. Additionally, the contracting officer in her September 1, 2011 request for audit specifically requested that DCAA contact her ‘immediately’ should the DCAA audit field work identify any significant proposed costs that were unsupported.

As described in Finding A, the DCAA work papers do not provide a record of any communications held with the contracting officer to discuss any issues or problems arising during the course of the audit. The administrative working papers in section 07 Government Notes/Correspondence do not document the results of any discussions and/or communications held with the contracting officer.

The [REDACTED] August 18, 2011 proposal was the third proposal submitted by [REDACTED] in response to the AMCOM request for proposal dated October 29, 2010. The first proposal was submitted by [REDACTED] on March 12, 2010. On April 27, 2010, DCAA determined the proposal was inadequate and advised the PCO they would not proceed with an audit. The second proposal was submitted by [REDACTED] on November 16, 2010. DCAA performed an adequacy review and on December 3, 2010 determined the proposal to be inadequate. On December 6, 2010, the AMCOM contracting officer submitted a formal rejection notice to [REDACTED]. Through January 2011 the contracting officer worked with [REDACTED] on proposal adequacy issues. On January 19, 2011, a web conference was held with [REDACTED] and representatives of AMCOM, DCMA, and DCAA to discuss the path forward for submission of an acceptable proposal.

⁶ FAR 15.408 Table 15-2 provides contractors a format for submission of cost or pricing data when certified cost or pricing data are required by the contracting officer in accordance with FAR 15.403-4 – Requiring Certified Cost or Pricing Data (10 U.S.C. 2306a and 41 U.S.C. 254b).

Attachment 11 (cont'd)

Regarding the adequacy of third [REDACTED] proposal dated August 18, 2011, DCAA and the contracting officer attended a proposal walk-through provided by [REDACTED] from August 30 through September 1, 2011. On October 3, 2011 DCAA advised the PCO by memorandum that they had "... completed their adequacy review of the proposal and, at this time, consider it adequate." DCAA commenced its audit thereafter.

The DCAA work papers documenting the adequacy review of the [REDACTED] August 18, 2011 proposal do not identify the proposal inadequacies observed by DCAA in the review of the [REDACTED] March 12, 2010 and November 16, 2010 proposals. The DCAA working papers also do not demonstrate that [REDACTED] had corrected the previously identified inadequacies with the submission of their August 18, 2011 proposal.

On December 20, 2011, DCAA issued a memorandum to the PCO notifying her that the deficiencies in cost or pricing data submitted by [REDACTED] and identified by DCAA in their on-going audit of the [REDACTED] August 18, 2011 proposal were significant. DCAA advised the contracting officer that the final DCAA report would render an adverse opinion and state that the proposal was not an acceptable basis for negotiation of a fair and reasonable price. Deficiencies identified by DCAA in the memorandum included:

- Proposed material costs of \$147,707,896 were unsupported for various reasons including inadequate subcontractor cost or pricing data submissions, inadequate and incomplete cost price analyses on subcontractors, and lack of supporting documentation.
- Proposed recurring labor hours (486,352) were unsupported due to the use by [REDACTED] of unauditable historical cost or pricing data.

According to the contracting officer, DCAA advised her prior to the audit exit conference held on January 30, 2012 that the [REDACTED] proposal was inadequate. The contracting officer stated she would not have required a DCAA audit of an inadequate proposal if she had been advised at the start of the audit that it was inadequate. According to the contracting officer, DCAA advised her that the proposal was "adequate for field work" but not "adequate as a proposal."

On February 3, 2012 DCAA issued Audit Report No. 4821-2011R21000012. DCAA reported that the cost or pricing data submitted by [REDACTED] in support of proposed direct labor, direct material, Interdivisional Work Authorizations (IWA), Other Direct Costs (ODC), indirect costs for Calendar Years (CYs) 2008 through 2010, and recorded direct costs was not adequate. DCAA reported that because these inadequacies were significant, DCAA did not believe the proposal was an acceptable basis for negotiation of a fair and reasonable price. DCAA reported that to make the cost or pricing data adequate, [REDACTED] must provide adequate cost or pricing data support, perform adequate cost price analyses, provide adequate documentation to support basis of estimates, and demonstrate continuing reasonableness of the proposed costs.

The following table depicts the proposed direct labor, direct material, Interdivisional Work Authorizations (IWA), Other Direct Costs (ODC), indirect costs for Calendar Years (CYs) 2008 through 2010, and recorded direct costs included in the [REDACTED] August 18, 2012 proposal that

Attachment 11 (cont'd)

DCAA reported as not adequate and not acceptable as basis for negotiation of a fair and reasonable price:

Direct Labor	\$164,520,807
Direct Material	212,666,200
DH-MD Interdivisional Work Authorization Material	27,856,443
Other Direct Costs	29,353,302
IWA Costs	90,082,699
Recorded Indirect Costs, 2008 - 2010	<u>15,662,605</u>
Total Cost	<u>\$540,142,056</u>

With so much proposed costs found inadequate by DCAA, the contracting officer advised the OIG that she was left in a position where she could not negotiate a contract under AMCOM guidelines.

After receipt of the DCAA audit report, the contracting officer convened the 'LRIP Proposal DCAA Audit Walkthrough and Technical Fact Finding Summit' at the [REDACTED] facility from February 6 through 24, 2012 (see Finding E). The contracting officer advised the OIG that the purpose of the 'summit' was to sit with DCAA to reconcile the gaps in the audit findings and the request for audit and to make the audit report useable for negotiating the contract. One factor leading to the need to convene the summit was DCAA reporting that [REDACTED] had not submitted adequate cost or pricing to support a majority of their proposed cost.

Recommendation B

The Director, DCAA should evaluate DCAA audit policy for performing adequacy reviews of contractor proposals and make the revisions necessary to provide reasonable assurance that:

1. For any proposals that have been resubmitted due to a previous DCAA finding of inadequacy, the DCAA auditor evaluates the resubmitted proposal and determines that the proposal has been corrected for each previously identified deficiency.
2. The actions taken by the auditor to attest that previously identified deficiencies have been corrected by the contractor are appropriately documented in the working papers.
3. Where the auditor identifies in the evaluation of the current proposal that a previously identified deficiency has resulted in the contractor submitting inadequate cost or pricing data to support proposed cost, the auditor will issue a report to the administrative contracting officer identifying the business system deficiency, as appropriate.

Attachment 11 (cont'd)

Finding C. DCAA was untimely in notifying the contracting officer that they were not auditing the proposed indirect rates

The September 1, 2011 contracting officer request for DCAA audit of [REDACTED] Proposal No. 5030-0052.6, dated August 18, 2011 included the following areas for DCAA review:

Validity of Section 1.5 Rates/Factors/Disclosures – request verification of, but not limited to, rates/factors/pricing methodology.

And

Validity of Section 2 Cost Summaries – request verification of rates/factors/pricing methodology and facilities cost of money.

FAR 15.404-2(a) provides that the contracting officer shall tailor requests for field pricing assistance to "...reflect the minimum essential supplementary information needed to conduct a technical or cost or pricing analysis."

[REDACTED] Proposal No. 5030-0052.6, dated August 18, 2011 for [REDACTED] Low Rate Initial Production (LRIP) Definitization Proposal included the following proposed indirect costs that were contingent upon a review of the corresponding proposed rates:

Overhead	\$74,857,185
General & Administrative	63,592,806
Facilities Capital Cost of Money	<u>2,201,648</u>
	<u>\$140,651,639</u>

As described in Finding A, the DCAA work papers do not provide a record of any communications held with the contracting officer before beginning the audit to gain a clear understanding of the contracting officer's needs, to identify specific areas of concerns, and to discuss how DCAA can best meet those needs and address the requestor's concerns while complying with GAGAS.

FAR 15.404-2(c) *Audit assistance for prime contracts or subcontracts* provides at paragraph (3) that the auditor is responsible for the scope and depth of the audit. The DCAA work papers demonstrate that DCAA determined during audit planning and risk assessment that they would not audit the [REDACTED] proposed indirect rates:

- Audit work paper B-01, entitled "AUDIT PLANNING CONSIDERATIONS AND PRELIMINARY AUDIT STEPS" and initialed and dated by the audit staff on September 14, September 27 and October 3, 2011, provided that DCAA would not perform any review procedures to audit the proposed indirect rates.
- Audit work paper N-01, entitled "INDIRECT RATES – NO AUDITED RATES..." and initialed and dated by the audit staff on September 7, 2011, provided that DCAA would not perform any review procedures to audit proposed indirect rates and included the following note on the work paper:

Attachment 11 (cont'd)

“We will disclaim an opinion on Indirect Rates from 2011 forward. We do not have audited Indirect Rates and do not expect to have audited Indirect Rates prior to the issuance of our audit report.”

On October 3, 2011 DCAA issued a memorandum to the contracting officer in response to her September 1, 2011 request for audit. DCAA advised the contracting officer as follows regarding her request that DCAA review rates:

“At this time, we will not be evaluating indirect rates or pricing factors; however, we will evaluate these areas if a DCAA audit on these areas has been issued prior to the issuance of the audit report on this proposal.”

Subsequent to the October 3, 2011 memorandum, DCAA did not perform any audit work to review the [REDACTED] proposed indirect rates: In audit work paper N-02 initialed and dated by the audit staff on December 20, 2011 and entitled “Audit of [REDACTED] LRIP Proposal Under Contract [REDACTED]”, DCAA documented the audit of indirect rates as follows:

- DCAA did not have an audit position on the indirect rates.
- DCAA [REDACTED] had not issued an audit report on the [REDACTED] proposed indirect rates since 2008.
- Since 2008, DCAA had not issued an audit report on seventeen (17) [REDACTED] forward pricing rate proposals.
- DCAA [REDACTED] had been unable to complete the audit of a [REDACTED] forward pricing rate proposal before [REDACTED] had issued the next FPRP. The work paper explains that this is partly due to waiting for DCAA audits of significant [REDACTED] flow down cost from other DCAA locations and because [REDACTED] is in the habit of submitting a new FPRP at least 6 times a year.
- The work paper provided that DCAA [REDACTED] would follow the Guidance in DCAA Audit Alert 10-PSP-018(R), dated June 4, 2010⁷ and that DCAA would disclaim an opinion on indirect rates. The work paper provided that “The proposed indirect rates have not/are not being audited.”

On December 20, 2011, DCAA issued a memorandum notifying the contracting officer of various issues encountered in the audit. Regarding indirect rates, DCAA notified the contracting officer that it had not examined the proposed indirect rates and, as a result, would disclaim an opinion on the proposed indirect costs in its upcoming audit report. Additionally, DCAA advised the contracting officer that:

“We believe that consideration of audited indirect expense rates ... is a significant matter for this procurement. We recommend final negotiations

⁷ The DCAA audit alert clarified DCAA audit policy on the reporting on forward pricing rates included in pricing proposals when the audit of rates has not been completed at the time of report issuance. In summary, the audit alert provided that since direct and/or indirect rates usually represent such a significant portion of a pricing proposal, auditors should disclaim an opinion on the proposal taken as a whole if the audit of those rates has not been completed.

Attachment 11 (cont'd)

not be completed until audits of the proposed indirect expense rates ... are completed.

On February 3, 2012, DCAA issued Audit Report No. 4821-2011R21000012. DCAA reported that the scope of audit was not sufficient to enable DCAA to express an opinion on whether the proposed indirect expense rates for Calendar Years (CYs) 2011 and beyond were in all respects based on FAR, DFARS, and CAS, and acceptable as a basis for negotiating a fair and reasonable price. DCAA reported that this was because they had not completed an examination of those portions of the forward pricing rate packages used in this proposal or any subsequent forward pricing rate submissions. DCAA recommended that final contract negotiations not be completed until DCAA could finish their audit and determine whether such proposed costs were in all respects based on the procurement regulations and acceptable for negotiation of a fair and reasonable price. The DCAA report did not provide a completion date for this work.

After receipt of the DCAA audit report, the contracting officer convened the 'LRIP Proposal DCAA Audit Walkthrough and Technical Fact Finding Summit' at the [REDACTED] facility on February 6 through 24, 2012 (see Finding E). The contracting officer advised the OIG that the purpose of the 'summit' was to sit with DCAA to reconcile the gaps in the audit findings and the request for audit and to make the audit report useable for negotiating the contract. The contracting officer identified the omission by DCAA of the review of proposed indirect rates as one of the reasons for convening the fact-finding summit.

Subsequent to the DCAA audit report, the contracting officer obtained the Defense Contract Management Agency (DCMA) Forward Pricing Rate Recommendation (FPRR)⁸ dated March 16, 2012. The DCMA FPRR was established without DCAA audit support and was used by the contracting officer to establish the U.S. Government negotiation position for indirect costs, rates and factors.

DCAA audit policy at DCAM 9-103.1a provides the following:

In responding to requests for audit services, FAO managers, supervisors, and auditors should keep in mind that the PCO and ACO are the primary users of our services. Our aim is to provide timely and responsive audits, audit reports and financial advisory services that meet the user's needs. This goal can be achieved by establishing open and effective channels of communication that allow for the sharing of information and ideas as the audit progresses. FAR 15.404-2(a)(3) encourages PCOs to team with appropriate field experts and to communicate early in the acquisition process.

⁸ By Memorandum dated September 14, 2010, the Under Secretary of Defense (Acquisition, Technology and Logistics) established DoD policy allowing the use of DCMA FPRR's to 'ensure contracting officer's obtain the support they need to negotiate rates' and 'where there is not a legitimate and thoughtful basis for departing from them.'

Attachment 11 (cont'd)

The DCAA work papers do not demonstrate that DCAA [REDACTED] met the DCAA aim and goal as established at DCAM 9-103.1a and established an open and effective channel of communication with the contracting officer in responding to the request to review rates.

Recommendation C

1. The Director, DCAA should evaluate DCAA audit policy for auditing contractor proposed indirect rates and make the revisions necessary to provide reasonable assurance that:
 - a. DCAA audit policy results in DCAA auditors advising contracting officers when acknowledging any requests for price proposal audit assistance that DCMA forward pricing rate recommendations are available for contracting officer use in lieu of DCAA audited rates at those contractor locations where DCAA cannot provide a rate recommendation in a timely manner.
 - b. DCAA audit policy included in DCAA Audit Alert 10-PSP-018(R), dated June 4, 2010 has not unduly restricted DCAA capability to provide audit recommendations on contractor forward pricing rate proposals while complying with GAGAS.
 - c. DCAA audit policy for performing rate proposal audits at large, multi-segmented contractors like the [REDACTED] is providing field auditors with the right mix of audit procedures and techniques to assist DoD contracting officers in negotiating fair and reasonable contract prices while complying with Government Auditing Standards.
2. The Resident Auditor, DCAA [REDACTED] Resident Office should implement procedures that provide reasonable assurance that the auditors will advise contracting officers requesting audit assistance from DCAA [REDACTED] that:
 - a. Forward pricing rate recommendations are available from the DCMA Divisional Administrative Contracting Officer.
 - b. The current status of any forward pricing rate audits and a conservative estimate on the likelihood that DCAA will complete the audit and issue an audit report in time for use by the contracting officer in negotiating the pricing action under consideration.
3. Plan and begin implementing actions that will allow DCAA [REDACTED] to provide timely accounting and advisory services to the DCMA administrative contracting officer in connection with the review of the contractor's forward pricing rate proposal(s) and establishment of forward pricing rate agreements at [REDACTED].

Attachment 11 (cont'd)

Finding D. DCAA did not establish and maintain effective communications with the contracting officer in the audit of proposed labor hours

The contracting officer did not request that DCAA review proposed labor hours in her September 1, 2011 request for audit of [REDACTED] Proposal No. [REDACTED], dated August 18, 2011. FAR 15.404-2(a) provides that the contracting officer shall tailor requests for field pricing assistance to "...reflect the minimum essential supplementary information needed to conduct a technical or cost or pricing analysis." The contracting officer had technical expertise available and on September 2, 2011 the contracting officer requested a technical evaluation of proposed labor hours from the Army [REDACTED] Program Manager's Office. The contracting officer advised the OIG that DCAA audited the proposed labor hours even though the contracting officer requested from the outset that they not.

FAR 15.404-2(c) *Audit assistance for prime contracts or subcontracts* provides at paragraph (3) that the auditor is responsible for the scope and depth of the audit. DCAA audit policy at DCAM 9-103.1a states that the aim of DCAA is to provide timely and responsive audits and audit reports that meet the user's needs. It provides that this goal can be achieved by establishing open and effective channels of communication that allow for the sharing of information and ideas as the audit progresses.

DCAA audit policy at DCAM 4-104a provides that if the auditor is aware of risk factors that indicate additional parts of a proposal should be audited, the auditor should discuss those risks with the contracting officer. Additionally, DCAM 9-103.1d(4) states in part that "the auditor should coordinate with the requestor, upon completion of the risk assessment, to resolve any inconsistencies between the requested audit effort and the scope of audit determined by the auditor's assessed level of risk".

The DCAA work papers do not document that DCAA discussed with the contracting officer any additional risk factors associated with the proposed direct labor hours and why these risk factors necessitated additional audit scope and depth⁹. The closest the work papers come to documenting such a discussion is working paper B-01, section B-1, step 3.c, where the auditors annotated after an audit step that "AMCOM did not request it; however, we will be performing the labor section. AMCOM did not object."

DCAA expended 1,408 hours auditing proposed labor hours. In the Exhibit to Audit Report No. 4821-2011R21000012, DCAA reported that it questioned 604,144 proposed labor hours and unsupported 391,986 proposed labor hours. DCAA findings included the following:

- DCAA questioned the reasonableness of 264,103 Non-Recurring direct labor hours through the evaluation of data derived from the [REDACTED] Estimate at Completion and Earned Value Management System.

⁹ DCAM 9-103.1d(4) states in part that "the auditor should coordinate with the requestor, upon completion of the risk assessment, to resolve any inconsistencies between the requested audit effort and the scope of audit determined by the auditor's assessed level of risk".

Attachment 11 (cont'd)

- DCAA unsupported 175,403 Touch Labor hours after determining that the historical cost data used by [REDACTED] in a proposed improvement curve was not auditable as it had been derived from a database that had not been maintained since its creation and the systems used to pull the source data were unknown.

In both cases DCAA determined in October, 2011 that the [REDACTED] labor hour estimates could not be relied upon to negotiate a fair and reasonable contract price for labor hours. In each case DCAA performed alternative audit procedures to arrive at the DCAA audit position included in Audit Report No. 4821-2011R21000012. DCAA audit policy at DCAM 9-103.1a provides that DCAA can meet its goal to provide timely and responsive audit reports that meet the contracting officer's needs by establishing open channels of communication with the contracting officer that allow for the sharing of information and ideas as the audit progresses. In neither case do the DCAA work papers demonstrate that DCAA advised and shared with the contracting officer their finding that [REDACTED] had unsupported labor hour estimates even though the contracting officer had specifically requested that DCAA share such information "immediately".

Additionally, DCAA unilaterally evaluated the learning and efficiency curves used by the contractor to support the reasonableness of proposed touch labor hours. Based upon the evaluation, DCAA questioned 114,217 direct labor hours in their February 3, 2012 audit report.

After receipt of the DCAA audit report, the contracting officer convened the 'LRIP Proposal DCAA Audit Walkthrough and Technical Fact Finding Summit' at the [REDACTED] facility from February 6 through 24, 2012 (see Finding E). The Apache Block III technical team and DCAA laid out their positions at the Summit and in the labor category it was determined that a combination of the AMCOM and DCAA efforts would be utilized to establish a negotiation position. The contracting officer advised the OIG that AMCOM utilized the DCAA system for evaluating contractor actual labor hour historical data but did not use the DCAA learning curve technique.

Recommendation D

The Resident Auditor, DCAA [REDACTED] Resident Office, should implement procedures that provide reasonable assurance that the audit staff complies with the requirements of DCAM 9-103.1a and establish open channels of communication with the contracting officer that allow for the sharing of information and ideas as the audit progresses.

Finding E. The DCAA audit report did not meet the needs of the Contracting Officer

DCAA Audit Report No. 4821-2011R21000012 dated February 3, 2012 did not meet the needs of the contracting officer. DCAA audit policy at DCAM 9-103.1 Coordination of the Request – Field Pricing Support, provides in part that:

Our aim is to provide timely and responsive audits, audit reports and financial advisory services that meet the user's needs.

Attachment 11 (cont'd)

Additionally, DCAA audit guidance at DCAM 10-302 provides in part that:

The audit report should contain the necessary and pertinent information disclosed by the audit, which will assist the contracting officer in negotiating with the contractor. [DCAM 10-302a]

And

The auditor should coordinate with the customer while planning the audit. Reports should comment on areas emphasized in the request. [DCAM 10-302b]

After receipt of the DCAA audit report, the contracting officer had to convene a conference called the 'LRIP Proposal DCAA Audit Walkthrough and Technical Fact Finding Summit' at the DCAA office at the [REDACTED] facility from February 6 through 24, 2012. The contracting officer advised the OIG that the purpose of the 'summit' was to sit with DCAA to reconcile the gaps in the audit findings and the request for audit and to make the audit report useable for negotiating the contract. Under AMCOM guidelines the contracting officer could not negotiate a contract using the DCAA audit report. The contracting officer identified the following problems with the services provided by DCAA and the DCAA audit report:

- The DCAA report did not address all the items the contracting officer had requested DCAA review in her request for audit, including a review of the proposed indirect rates (see Finding C).
- DCAA only audited 'roughly 50 percent' of the proposal and found that the part audited was not acceptable for negotiating a fair and reasonable price.
- DCAA provided conflicting advice on the adequacy of the proposal (see Finding B).
- Untimely notice by DCAA to the contracting officer that [REDACTED] did not have auditable support for the historical labor hours used to support its learning curve used as a basis of estimate for proposed labor hours. Timely notice could have avoided significant rework by the AMCOM team of 20 engineers who were generating the Government's technical position for the same effort (see Finding D).
- The DCAA reported findings on proposed material cost did not reconcile to the contractor's proposal. It took intervention by AMCOM senior management to get DCAA to provide the DCAA working papers documenting the audit of material costs. This was not accomplished until the last week of the fact-finding summit. Even with the material audit working papers it took the contracting officer four weeks to reconcile the DCAA findings to the contractor's proposal.

The contracting officer advised the OIG that as a result of DCAA Audit Report No. 4821–2011R21000012, the Army Contracting Command – Redstone has made the use of post-audit report 'summits' a required practice for all DCAA audit reports received on proposals exceeding \$500 million.

Attachment 11 (cont'd)

Recommendation E

The Director, DCAA should take action to ensure that any DCAA price proposal audit reports issued in response to a request for audit originating from the Army Contracting Command – Redstone meet the needs of the contracting officer and can be used by the contracting officer to negotiate a contract without the contracting officer having to resort to the the use of post-audit report walkthroughs and technical fact-finding summits.

Finding F. DCAA overstated dollars examined, questioned costs, and net savings reported in the DCAA Management Information System

Appendix A to the DCAA Management Information System (Appendix A) provides guidelines for auditor use in calculating the monetary benefits resulting from DCAA audits. The amounts calculated using Appendix A are reported in the DCAA Management Information System (DMIS). The Overview to DMIS Appendix A states as follows:

The accuracy of data contained in DMIS is important to both internal and external customers. Internally, DMIS is used to provide DCAA managers with data to make informed decisions and to measure the success of audit activities. Data such as net savings are also reported outside the Agency to publicize our contribution to the acquisition process.

The monetary benefits generated by DCAA Audit Report No. 4821–2011R21000012 were first reported in the DCAA DMIS system on March 31, 2012. DCAA subsequently revised the amounts input to DMIS on Sept. 30, 2012, Dec. 10, 2012 and Jan. 17, 2013. The latter two revisions were made subsequent to the OIG making inquiries regarding the amounts reported in DMIS. The monetary benefits reported by the DCAA in DMIS for DCAA Audit Report No. 4821–2011R21000012 included significant errors and are overstated.

The following chart depicts dollars examined, questioned cost, and net savings reported in DMIS for DCAA Audit Report No. 4821–2011R21000012:

	Mar. 31, 2012	Sept. 30, 2012	Dec. 10, 2012	Jan. 17, 2013
Dollars Examined (000)	\$362,623	\$632,928	\$721,447	\$721,447
Questioned Cost (000)	\$77,815	\$116,556	\$113,459	\$62,125
Net Savings (000)	\$0	\$0	\$57,883	\$18,853

Reported Dollars Examined. After revising the amount reported in DMIS two times, DCAA reported dollars examined¹⁰ of \$721.5 million in DMIS. However, DCAA overstated dollars examined by including contractor proposed profit of \$132.9 million and contractor proposed

¹⁰ Dollars examined is an attempt to capture the amount of proposed cost included in the contractor's proposal that DCAA audited. However, Appendix A to the DMIS manual does not provide a definition of the term 'dollars examined'.

Attachment 11 (cont'd)

indirect costs of \$145.7 million in the \$721.5 million reported in DMIS. But for the overstatements, reported dollars examined should be \$485.6 million as of January 17, 2013. DCAA did not audit profit or proposed indirect costs or report audit results for profit or indirect costs in DCAA Audit Report No. 4821–2011R21000012.

Regarding contractor proposed profit, DMIS Appendix A provides in Section V – Forward Pricing that dollars examined will be based on the contractor's total proposal amount, including profit. However, DCAA audit policy at DCAM 9-906.6 states that:

The auditor will not initiate action in the profit area except upon specific contracting officer request. In this event, the auditor's effort will be limited to furnishing the information or factual data requested.

The contracting officer in her September 1, 2011 request for DCAA audit services did not request DCAA audit assistance with the review of profit or request that DCAA furnish any specific information or factual data related to proposed profit.

On February 1, 2013, the OIG requested that DCAA Headquarters provide rationale for the DCAA DMIS policy to claim profit as a part of the dollars examined where DCAA did not audit profit and did not assist the contracting officer in the profit area. On February 20, 2013 DCAA Headquarters responded in part that:

“Profit has been part of dollars examined for proposal audits as far back as 1979 which is the oldest information we can find. We have concluded that profit was included in dollars examined because (1) audit reports on price proposals display profit as part of the proposed amount, and (2) we examine the base dollars for which the profit amounts are dependent and the amount of profit negotiated will be affected by the base cost to which the profit percentage is applied.”

In performing the audit of [REDACTED] Proposal No. [REDACTED] dated August 18, 2011, DCAA was not requested to review profit; DCAA did not review profit; and, DCAA did not provide the contracting officer with an audit opinion regarding the reasonableness of proposed profit. Additionally, DCAA audit policy at DCAM 9-906.6 provides that the auditor will not initiate an audit of profit. By including \$132.9 million in proposed profit in the dollars examined reported in DMIS, DCAA is taking monetary credit for examining an element of the contractor's proposal, profit, which they did not audit.

Regarding contractor proposed indirect costs, Finding C above established that the contracting officer requested that DCAA review rates/factors/pricing methodology/and facilities cost of money but that DCAA elected not perform the requested audit and did not provide an opinion on the proposed indirect costs for Calendar Years (CYs) 2011 and beyond. Finding C also established that the contracting officer subsequent to the DCAA audit report obtained a forward pricing rate recommendation (FPRR) from another DoD agency, the Defense Contract Management Agency (DCMA) and used those rates to establish her negotiation position for

Attachment 11 (cont'd)

indirect costs. Finding B also established that DCMA established the FPRR without the assistance of DCAA.

On February 1, 2013, the OIG requested that DCAA Headquarters provide rationale for the DCAA DMIS policy to claim indirect costs as a part of the dollars examined, questioned cost and net savings where DCAA did not provide an opinion on proposed indirect costs and another DoD agency provided the contracting officer with the field pricing assistance on rates. On February 20, 2013 DCAA responded in part that:

“DCAA reports dollars related to the parts of the proposal audited plus associated indirect expense because if the base cost is negotiated at a lower price than that proposed by the contractor, then indirect expenses negotiated will change in direct proportion. The changes in the negotiated contract values of the direct base cost and the indirect expenses are a direct result of the audit services provided by DCAA. Once negotiations have been held and a PNM is issued, DCAA FAO staff evaluates the PNM to determine the amounts sustained attributable to the services provided by DCAA and record the amounts in DMIS. The amounts are reported in DMIS and serve as a way for DCAA to measure the value of those audit services and the benefits received. In the case of audits of parts of a proposal, the value of audit services will extend beyond the amounts shown in the audit report.”

In performing the audit of the [REDACTED] proposal, DCAA was requested to review rates/factors/pricing methodology/and facilities cost of money. DCAA elected not to perform the service and did not provide the contracting officer with an audit opinion regarding the reasonableness of proposed indirect rates. In fact, another DoD agency, DCMA, was responsive to the contracting officer's needs and provided field pricing support for rates without the assistance of DCAA. By including \$145.7 million in proposed indirect costs in the dollars examined in DMIS, DCAA is taking monetary credit for examining contractor proposed cost that they did not audit. They are also taking monetary credit for the review of an element of the contractor's proposal that another DoD agency elected to review and provide assistance to the AMCOM contracting officer.

Reported Questioned Cost. DCAA reported questioned cost of \$62.1 million in DMIS on January 17, 2013. This amount was the result of three revisions made to DMIS by DCAA to correct for errors and overstatements. The errors and overstatements totaled \$93.2 million and are comprised of:

- \$38.7 million in questioned indirect costs that DCAA did not audit and for which DCMA provided the contracting officer with field pricing support,
- \$3.1 million in questioned cost claimed by DCAA [REDACTED] but attributable to work performed by another DCAA field audit office under an assist audit report, and
- \$51.4 million in findings originating from a DCMA technical review but for which DCAA reported the questioned cost in DMIS.

Attachment 11 (cont'd)

But for these errors and overstatements, reported questioned cost in DMIS would be \$45.9 million as of January 17, 2013.

On September 30, 2012, DCAA increased the amount of questioned cost originally reported in DMIS from \$77.8 million to \$116.6 million, an increase of \$38.7 million. On inquiry, DCAA advised the OIG that the increase of \$38.7 million was for the addition of questioned indirect costs. Thereafter, the amounts reported as questioned cost in DMIS for DCAA Audit Report No. 4821-2011R21000012 include applicable proposed indirect costs.

DMIS Appendix A provides in Section V – Forward Pricing that the amount that is reported is the questioned cost for all proposed cost elements plus applicable indirect costs¹¹.

Along with reported dollars examined, we requested that DCAA Headquarters provide rationale for the DCAA DMIS policy to claim indirect costs as a part of the questioned cost reported where DCAA did not provide an opinion on proposed indirect costs and another DoD agency provided the contracting officer with the field pricing assistance on rates. The DCAA Headquarters response is provided above in the discussion on reported dollars examined. For the same reasons identified above for reported dollars examined, DCAA should not claim any monetary benefits for questioned proposed indirect cost where DCAA did not audit the proposed indirect rates and another DoD agency provided the field pricing assistance.

On December 10, 2012 DCAA revised the reported questioned cost of \$116.6 million downward by \$3.1 million to \$113.5 million. The reduction was made to reduce the questioned cost claimed by DCAA [REDACTED] for an assist audit report performed by another DCAA office and reportable by that office in DMIS.

DCAA guidance provided in DMIS Appendix A Section V – Forward Pricing states in part that:

Amounts questioned in subcontract/interdivisional assist audit reports will be reported by the field audit office performing the assist audit; accordingly, these amounts should not be reported by the recipient field audit office.

On January 17, 2013, DCAA revised the reported questioned cost of \$113.5 million downward by \$51.4 million to \$62.1 million. The reduction was made to reduce the reported questioned cost in DMIS for work performed by DCMA, another DoD agency, in a technical review. On December 10, 2012 the OIG requested that DCAA explain why the questioned cost of \$113.5 million reported in DMIS on December 10, 2012 had not been reduced for the technical report received from DCMA. In DCAA Audit Report No. 4821-2011R21000012, DCAA had incorporated the results of the DCMA December 21, 2011 technical review into the reported audit findings.

¹¹ Unlike the DCAA Appendix A guidance for reporting dollars examined, DMIS Appendix A does not provide that profit be added to questioned cost.

Attachment 11 (cont'd)

DMIS Appendix A, Section V – Forward Pricing states in part that:

When the results of the technical review are incorporated into the DCAA audit report the resulting questioned costs based on the technical review will not be incorporated in the DMIS.

Reported Net Savings. On Dec. 10, 2012 DCAA reported net savings of \$57.9 million resulting from DCAA Audit Report No. 4821–2011R21000012. After inquiry by the OIG, DCAA revised this amount to \$18.9 million on January 17, 2013. However, the \$18.9 million was not calculated in accordance with DMIS Appendix A, Section V – Forward Pricing and may not accurately report net savings, if any, that may have resulted from DCAA Audit Report No. 4821–2011R21000012.

The contracting officer provided the price negotiation memorandum (PNM) to DCAA on August 1, 2012. DMIS Appendix A provides that “upon receipt of the PNM from the procurement activity, amounts sustained and the resulting net savings should be promptly computed and reported in DMIS.” In response to the OIG, DCAA responded on November 21, 2012 that the calculated net savings was undergoing managerial review. Subsequently, DCAA reported net savings of \$57.9 million in DMIS on Dec. 10, 2012.

Regarding reported questioned cost sustained and net savings, DMIS Appendix A, Section V – Forward Pricing provides in part that:

- The contracting officer’s price negotiation memorandum “...should be carefully reviewed and compared to the audit report to determine the extent of audit exceptions sustained”
- If the PNM “...is unclear on any significant audit exceptions or issues, the negotiator should be contacted for clarification”, and
- Amounts reported as sustained in the DMIS will exclude amounts attributable to assist audits and technical reviews.”

On December 10, 2012 the OIG requested that DCAA explain (i) why the questioned cost amount reported in DMIS was not reduced for the technical reports, (ii) why a revised [REDACTED] proposal that was not audited by DCAA was used as the basis for calculating net savings, and (iii) how the net savings amount was adjusted for items that were potentially reduced in negotiations for reasons other than the DCAA audit report.

In their response dated December 18, 2012, DCAA:

- Agreed that the portion of question costs applicable to the DCMA technical evaluation should be removed,
- Agreed that the calculation of net savings should be based on the original audited proposal, and
- Agreed to revise their DMIS calculations and update DMIS accordingly to show how the net saving amount was adjusted for items that were potentially reduced in negotiations for reasons other than the DCAA audit.

Attachment 11 (cont'd)

On January 17, 2013 DCAA revised the reported net savings in DMIS to \$18.9 million. The detailed calculations provided by DCAA demonstrate that the revised net savings amount of \$18.9 million was (i) based on the original [REDACTED] proposal that DCAA had audited and (ii) was adjusted for the DCMA technical report. However, the DCAA calculated net savings of \$18.9 million did not comply with the DCAA guidance provided in DMIS Appendix A, Section V – Forward Pricing. The net savings of \$18.9 million did not result from a careful review of the contracting officer's PNM and a determination of which audit exceptions reported in Audit Report No. 4821–2011R21000012, if any, had been sustained by the contracting officer.

Instead DCAA performed a top level review of the contracting officer's PNM and reported net savings for those major cost elements where the negotiated amount was less than the amount proposed by [REDACTED] in their August 18, 2011 proposal. Where this was the case, DCAA computed net savings for that cost element by applying a ratio DCAA computed that represented DCAA questioned cost reduced for the impact of the DCMA technical review findings. Using this approach, DCAA claimed net savings for the following major cost elements included in the [REDACTED] August 18, 2011 proposal:

Proposed Cost Element:	DCAA Claimed Net Savings
Direct Labor Dollars	\$1,523,190
Labor Burden	\$760,316
Material	\$13,294,693
Material Burden	\$543,589
Overhead	\$73,792
Factored Other Direct Cost	\$402,469
Facilities Capital Cost of Money	\$70,586
Total	\$16,668,635

However, DCAA elected to not report any net savings where the negotiated amount for a major cost element was more than the amount proposed by [REDACTED] in their August 18, 2011 proposal. We note that for these cost elements, the negotiated amount was less than the amount proposed by [REDACTED] in its revised proposal that DCAA did not audit. As a result, DCAA did not report net savings for the following cost elements:

Proposed Cost Element:	DCAA Claimed Net Savings
Other Direct Costs	\$0
Interdivisional Work Authorizations	\$0
General & Administrative Expense	\$0

DCAA added profit of \$2,183,591 to the \$16,668,635 in net savings calculated above to arrive at a reported net savings of \$18,852,226. This is the amount reported as net savings in DMIS on January 17, 2013 for DCAA Audit Report No. 4821–2011R21000012 and may, or may not, represent questioned cost reported by the DCAA and sustained by the contracting officer.

Attachment 11 (cont'd)

Recommendation F

1. The Director, DCAA should evaluate DCAA guidance for reporting price proposal audit results in DMIS to ensure that such guidance provides reasonable assurance that DCAA:
 - a. Correctly reports dollars examined, questioned cost and net savings when
 - i. DCAA did not audit and report on contractor proposed rates, and
 - ii. another DoD agency provided the contracting officer with field pricing assistance for evaluating contractor proposed rates and DCAA did not assist the other DoD agency in evaluating the contractor proposed rates.
 - b. Correctly reports dollars examined and net savings where DCAA did not audit and report on contractor proposed profit and the contracting officer did not request that DCAA furnish any specific factual information or data related to proposed profit.
 - c. Where it is determined through the review performed in items 1.a and 1.b above that the existing DMIS guidance did not result in the correct reporting of dollars examined, questioned cost and net savings in price proposal audits, consider the need to perform a self-assessment of amounts previously reported by DCAA in DMIS to ensure that such amounts are not significantly overstated.
 - d. Document the results of the actions taken in 1.a and 1.b and the determination to perform, or not perform, a self-assessment as recommended in 1.c.
2. The Director, DCAA should
 - a. Perform a preliminary study of DMIS reporting of price proposal audit results at other DCAA locations and determine that net savings has been calculated and reported in accordance with the requirements of DMIS Appendix A, Section V – Forward Pricing. This should include determining that the auditors:
 - i. Carefully reviewed and compared exceptions in the audit report to the audit exceptions sustained by the contracting officer as notated in the price negotiation memorandum,
 - ii. (ii). Contacted the negotiator where the price negotiation memorandum was unclear on any significant audit exceptions, and
 - iii. (iii). Excluded amounts attributable to assist audits and technical reviews from the amounts reported as sustained in DMIS.

Attachment 11 (cont'd)

- b. Where the preliminary study performed in 2.a shows that other DCAA locations have not reported net savings in accordance with the requirements of DMIS Appendix A, Section V – Forward Pricing, perform a self-assessment of the net savings amounts previously reported by DCAA in DMIS to ensure that such amounts are not significantly overstated.
 - c. Document the results of the preliminary study performed as a result of 2.a, and, if applicable, the self-assessment performed as a result of 2.b.
3. The Director, DCAA should direct an internal review of the net savings reported in DMIS for DCAA Audit Report No. 4821–2011R21000012 and determine whether the amount accurately depicts any monetary benefit that may have resulted from the DCAA Audit Report No. 4821–2011R21000012.

Concluding Remarks

We do not require a formal written response from DCAA at this time. We plan to issue a formal draft report covering the results of multiple high-risk oversight reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on factual matters discussed in this memorandum in advance of the draft report.

If you have any questions, please contact the undersigned or [REDACTED] at [REDACTED] or by email at [REDACTED]

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ou=DoD, ou=PKI, ou=DDIG,
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Date: 2013.05.10 12:17:00 -0400

Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 12



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

June 4, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
FIELD DETACHMENT

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 09881-2011A17100002 (APO HRR Memorandum No. 12, Project No. D2013-DAPOCF-0004.002)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 09881-2011A17100002, involving an audit of a contractor's claimed termination for convenience settlement proposal. Our review of the audit assignment disclosed no exceptions.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 09881-2011A17100002 as part of this effort.

Under this assignment, the field audit office (FAO) examined the contractor's February 5, 2011, termination for convenience settlement proposal in the amount of \$37,231,813. The purpose of the examination was to determine if the proposed termination costs were acceptable as a basis for negotiation. In a December 20, 2012, report, the FAO questioned \$6,652,844 of the contractor's proposed costs.

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the FAO:

- correctly applied appropriate criteria, such as the Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards;
- followed key Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

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Attachment 12 (cont'd)

To accomplish the objective, we obtained a copy of the assignment working paper package and reviewed other relevant documents. We did not perform a comprehensive review of the assignment for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of Assignment No. 09881-2011A17100002 disclosed no exceptions with the criteria applied, procedures followed, evidence gathered, or findings reported.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED].



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 13



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

July 10, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Results of DoD OIG High-Risk Review – Forward Pricing (HRR-FP) Regarding
DCAA Audit Report No. 4421-2012B21000001,
(APO HRR-FP Memorandum No. 13)

This memorandum sets forth the results of our oversight review of DCAA Audit Report No. 4421-2012B21000001 "Independent Audit of [REDACTED] Firm Fixed Price Proposal for [REDACTED] Multi-Year II [REDACTED] Proposal Updated on December 16, 2011" issued by the DCAA South Bay Branch Office on May 25, 2012. The oversight review is being performed under DoDIG Project No. D2012-DIP0AI-0013.

We selected DCAA Assignment No. 4421-2012B21000001 as a part of our responsibility to perform oversight of DCAA audits.

Our oversight review disclosed:

- DCAA needs to establish access to the [REDACTED] computerized accounting records. (Finding A)
- DCAA did not verify proposed part costs and prices to evidence created by an "arm's length" transaction. (Finding B)
- DCAA did not examine proposed labor hours for compliance with Cost Accounting Standard 401. (Finding C)
- Audit working papers do not demonstrate that the auditors complied with the Defense Contract Audit Manual (DCAM) Appendix D in performing sufficient audit work to determine the need for requesting technical assistance. (Finding D)

The resulting contract action should be audited for contractor compliance with (i) the Truth In Negotiations Act and (ii) compliance with the requirements and procedures in 48 CFR Chapter 99, Cost Accounting Standards, specifically as they pertain to Cost Accounting Standard 401. The Defense Contract Audit Agency, South Bay Branch Office, [REDACTED] Suboffice, should perform training and establish and implement procedures to provide reasonable assurance that pricing proposal audits are performed in accordance with existing DCAA audit policy.

DCAA expended 2,266 audit hours to issue DCAA Audit Report No. 4421-2012B21000001.

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Attachment 13 (cont'd)

Objective and Scope of High-Risk Review

The purpose of our oversight review is to evaluate whether the DCAA audit case file documentation (working papers) demonstrate that DCAA:

- Determined the adequacy of contractor cost or pricing data;
- Evaluated the contractor's proposal for compliance with Federal Acquisition Regulation (FAR), CAS, and existing DCAA policy; and
- Performed work sufficient to support the audit opinion on the acceptability of the contractor's proposed costs for negotiation of a fair and reasonable price.

Background

On January 5, 2012, the Defense Contract Management Agency (DCMA) – [REDACTED] contract management office requested the DCAA South Bay Branch Office perform a full field audit review of the [REDACTED] IWA Proposal, [REDACTED] Multi Year Update [REDACTED] Plus Option 60) Cost Proposal (Vol II)" firm-fixed price IWA (Inter-organizational Work Authorization) proposal. The IWA proposal was dated December 16, 2011 and was submitted by [REDACTED] in response to the [REDACTED] - Philadelphia proposal plan of action [REDACTED] Revision #7. The IWA proposal is for the manufacture and delivery of the Chinook 46 Aft Section Assemblies for the Baseline of [REDACTED]. In accordance with FAR 15.403-4 – Requiring Cost or Pricing Data (10 U.S.C. and 41 U.S.C. 254b), the contracting officer required [REDACTED] submit its proposal with certified cost or pricing data.

[REDACTED] proposal for [REDACTED] Multi-Year Proposal

Cost Elements	Proposed Cost
Direct Labor Hours	478,045
Direct Labor-CG	\$28,996,069
Direct Overhead	\$15,424,712
Site Overhead	\$3,475,167
Direct Material	\$57,557,634
Other Direct Costs (Value Added)	\$628,674
Other Direct Costs (Non Value Added)	\$575,576
G&A	\$12,747,418
FCCOM	\$110,791
Total Proposed Cost	\$119,516,041

Attachment 13 (cont'd)

Results of High-Risk Review

Finding A. DCAA needs to establish access to the [REDACTED] computerized accounting records

The contract clause at FAR 52.215-2, "Audit and Records – Negotiation," is the contract vehicle that gives DCAA auditors access to the contractor's accounting records. Paragraph (a) states:

As used in this clause, "records" includes books, documents, accounting procedures and practices, and other data, regardless of type and regardless of whether such items are in written form, in the form of computer data, or in any other form.

In addition, paragraph (f), "Availability," states that:

The Contractor shall make available at its office at all reasonable times the records, materials, and other evidence described in paragraphs (a), (b), (c), (d), and (e) of this clause, for examination, audit, or reproduction, until 3 years after final payment under this contract...

At the [REDACTED], the contractor's accounting system is computerized and accessed electronically through desk top terminals that require company-approved access and training. DCAA personnel advised the Office of Inspector General (OIG) that they do not have access to a desk top terminal; they do not have sufficient training to operate the system; and, DCAA does not have [REDACTED] approval to access the computerized accounting system. Instead, DCAA auditors relied on [REDACTED] personnel to access [REDACTED] computerized accounting system and run the auditor's procedures for the DCAA auditor.

DCAA Contract Audit Manual (DCAM) 3-204.12 states that:

Generally, the more sophisticated the contractor's technology and automation, the greater will be the reliability of the resulting data. However, the reliance cannot be blind; greater sophistication also can open doors to greater risks for mischarging or misallocating costs through multiple transactions hiding the results "in the computer." Generally, the audit trail becomes less distinct as the contractor's systems become more advanced. Therefore, the auditor must consider the results of prior audits, if any, of these sophisticated systems in determining the audit scope.

By establishing access to the [REDACTED] computerized accounting system at reasonable times, DCAA can ensure that its auditors are positioned to perform independent audit tests and procedures in accordance with the contract terms.

Recommendation A

The DCAA Branch Manager, South Bay Branch Office should:

1. Arrange for [REDACTED] to provide the necessary training or obtain the training from a third-party source that will allow for direct electronic access

Attachment 13 (cont'd)

to [REDACTED] records and computerized data in accordance with the requirements of the contract clause at FAR 52.215-2, "Audit and Records – Negotiation".

2. Establish DCAA access at all reasonable times to the [REDACTED] records and computerized data for audit, examination, or reproduction in accordance with the contract at FAR 52.215-2, "Audit and Records – Negotiation".
3. Ensure that DCAA auditors have independent access to [REDACTED] records of any type in accordance with the contract.

Finding B. DCAA did not verify proposed part costs and prices to evidence created by an "arm's length" transaction

The DCAA audit working papers do not substantiate that the [REDACTED] proposed cost of parts and unit prices originated from third party suppliers and resulted from an "arm's length" transaction with the supplier.

DCAA audit policy at DCAM 3-104.13 provides that for transactions that are generated externally, such as materials, the audit scope is often limited to verification to documentary evidence created by an "arm's length" party that substantiates the cost. In this case, that would be documentary evidence created by and resulting from an arm's length transaction between [REDACTED] and the supplier.

[REDACTED] supported proposed Purchased Parts cost of \$2,681,662 million with cost or pricing data in accordance with FAR 15.403-4 – *Requiring Certified Cost or Pricing Data (10 U.S.C. 2306a and 41 U.S.C. 254b)*. Likewise [REDACTED] supported, proposed Outside Manufacturing Subcontracts (Material Not Furnished by [REDACTED]) cost of \$48,511,720 with pricing data originating from competitive bids in accordance with FAR 15.403-3 – *Requiring Data Other Than Certified Cost or Pricing Data*.

Proposed Purchased Parts. In its December 16, 2011 proposal, [REDACTED] provided schedules to support an estimated \$2,681,662 in proposed purchased parts cost. The DCAA working papers demonstrate that [REDACTED] supported the proposed cost per part with cost or pricing data obtained from purchase contracts with a supplier or from quotes obtained from a supplier. In verifying the validity of the proposed cost per part, DCAA relied on purchase contracts and supplier quotes obtained from [REDACTED] that were on [REDACTED] letterhead. The DCAA audit working papers do not demonstrate that DCAA verified the proposed cost per part to documentation or information that originated from the supplier.

Outside Manufacturing Subcontracts (Material Not Furnished by [REDACTED]). In the same proposal, [REDACTED] provided information to support an estimated \$48,511,720 in Proposed Outside Manufacturing Subcontracts (Material Not Furnished by [REDACTED]). According to the DCAA working papers, [REDACTED] obtained competitive bids for each part, evaluated the supplier's bid and selected the winning bid values. Where the [REDACTED] proposed price was based on (1) adequate price competition; (2), the lowest bidder; and (3) the prices matched to a [REDACTED] long term agreement with a supplier, DCAA would not perform any additional audit testing. Where

Attachment 13 (cont'd)

DCAA found that the [REDACTED] proposed unit price did not meet these conditions, DCAA evaluated the bid selection process used by [REDACTED] including information found in the existing long term agreements to recommend an alternative unit price. Whether DCAA accepted the [REDACTED] proposed unit price or recommended an alternative unit price, the DCAA audit working papers do not demonstrate that DCAA verified the proposed unit price per part to documentation or information that originated from the supplier.

By verifying that the proposed part costs and unit prices originated from the supplier(s) and were the result of an "arm's length" transaction, the DCAA working papers could have demonstrated that [REDACTED] had complied with FAR 15.403-4 – *Requiring Certified Cost or Pricing Data (10 U.S.C. 2306a and 41 U.S.C. 254b)* and FAR 15.403-3 – *Requiring Data Other Than Certified Cost or Pricing Data* when proposing Purchased Parts cost and Outside Manufacturing Subcontracts (Material Not Furnished by [REDACTED]).

Recommendation B

The DCAA Branch Manager, South Bay Branch Office, should:

1. Provide the audit staff with training on the audit policy provided in DCAM 3-204.13.
2. Take corrective action to ensure that the audit staff correctly implements the audit policy at DCAM 3-204.13 when performing price proposal audits.
3. Consider performing a defective pricing audit on the contract action resulting from the negotiation of the [REDACTED] \$119,516,041 firm-fixed price Inter-organizational Work Authorization proposal for [REDACTED] Multi-Year II Update ([REDACTED] Option 60) to ensure that the negotiated contract price for work to be performed by [REDACTED] was not increased due to the submission of inadequate certified cost or pricing data.

Finding C. DCAA did not examine proposed labor hours for compliance with CAS 401

The DCAA working papers that support the auditor's opinion in DCAA Audit Report No. 4421-2012B21000001 did not demonstrate that DCAA examined the December 16, 2011, [REDACTED] Inter-Organizational Work Authorization proposal to ensure that the contractor complied with Cost Accounting Standard 401¹ Cost accounting standard – consistency in estimating, accumulating, and reporting costs (CAS 401)² when estimating proposed labor hours.

¹The Cost Accounting Standards Board rules, regulations, and standards are in 48 CFR, Chapter 99 – Cost Accounting Standards Board, Office of Federal Procurement Policy, Office of Management and Budget.

²In part, the purpose of CAS 401 as stated in 9904.401-20, "Purpose," is to "ensure that each contractor's practices used in estimating costs for a proposal are consistent with cost accounting practices used by him in accumulating and reporting costs. Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike. With respect to individual contracts, the consistent application of cost accounting practices will facilitate the preparation of reliable cost estimates used in pricing a proposal and their comparison with the costs of performance of the resulting contract. Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing accountability for cost in the manner agreed to by both parties at the time of contracting.

Attachment 13 (cont'd)

CAS 401-40, "Fundamental Requirement," provides that:

- (a) A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs.
- (b) A contractor's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal.

CAS 401-60, "Illustrations," provides an example of an application of a cost accounting practice deemed not to be consistent, as follows:

Practices used for estimating costs for proposals	Practices used in accumulating and reporting costs of contract performance
4. Contractor estimates a total dollar amount for engineering labor, which includes disparate and significant elements or functions of engineering labor. Contractor does not provide supporting data reconciling this amount to the estimates for the same engineering labor cost functions for which he will separately account in contract performance	4. Contractor accounts for engineering labor by cost function, i.e. drafting, designing, production, engineering, etc.

The DCAA working papers did not address a cost estimating practice included in the [REDACTED] proposal that demonstrates similarities with an illustration of the application of cost accounting practices deemed not to be consistent at CAS 401-60(b)4.

The [REDACTED] proposal included proposed direct labor cost of \$28,996,069 for 478,045 proposed direct labor hours under two labor categories, as follows:

[REDACTED] Assembly Hours	306,620
[REDACTED] Production Support Hours	171,425
Total labor hours proposed	478,045

A review of the [REDACTED] Cost Accounting Standards Board Disclosure Statement, Item No. 2.5.0 Method of Charging Direct Labor, demonstrated that [REDACTED] disclosed to the U.S. Government the following 10 labor categories under the Production labor element for the [REDACTED] facility:

1. Mechanical/Structural Engineering	2. Factory Modification
3. Factory: Fabrication	4. Operations Summary
5. Quality Assurance	6. Production Support and Control
7. Factory: Assembly	8. Manufacturing Engineering
9. Tool Fabrication	10. Tool Engineering

The DCAA working papers did not demonstrate that the auditors compared the two labor categories included in the [REDACTED] December 16, 2011, proposal to the 10 labor categories

Attachment 13 (cont'd)

disclosed by [REDACTED] in its Cost Accounting Standards Board Disclosure Statement for consistency.

On inquiry, DCAA advised the OIG that the [REDACTED]-proposed [REDACTED] Assembly Hours included Assembly and Factory Modification. However, Assembly is not a labor category included in the [REDACTED] CASB Disclosure Statement.

Likewise, DCAA advised the OIG that the [REDACTED]-proposed [REDACTED] Production Support Hours included eight labor categories. Six of these eight categories were included in the [REDACTED] CASB Disclosure Statement, as follows:

1. Factory: Fabrication	2. Production Support and Control
3. Quality Assurance	4. Manufacturing Engineering
5. Tool Fabrication	6. Tool Engineering

However, two labor categories (Program Support and Assembly Support) identified by DCAA as included in the [REDACTED]-proposed [REDACTED] Production Support Hours were not included by [REDACTED] in its CASB Disclosure Statement.

The DCAA working papers did not demonstrate that the auditors compared the cost estimating practices used by [REDACTED] to estimate [REDACTED] Assembly Hours and [REDACTED] Production Support Hours to the cost accounting practices used by [REDACTED] to accumulate and report the costs of contract performance. On inquiry, DCAA provided the OIG with a DCAA spreadsheet that identified [REDACTED]-recorded labor hours and costs as of July, 2012. On the spreadsheet, DCAA identified the following [REDACTED] labor categories:

Production Support	Assembly
Tool Engineering	Quality Assurance
Manufacturing Engineering	Factory: Fabrication
Factory Modification	Mechanical/Structural Engineering
Tool Fabrication	

However, the two labor categories included in the [REDACTED] December 16, 2011, proposal, [REDACTED] Assembly Hours and [REDACTED] Production Support Hours were not included in the DCAA spreadsheet.

The DCAA working papers did not demonstrate that the labor hours estimated by [REDACTED] for [REDACTED] Assembly Hours and [REDACTED] Production Support Hours did or did not include disparate and significant elements or functions of assembly and production support hours. Likewise, [REDACTED] in its December 16, 2011, proposal did not provide supporting data reconciling the proposed [REDACTED] Assembly Hours and [REDACTED] Production Support Hours to estimates for the same assembly and production support labor cost functions for which [REDACTED] will separately account in contract performance.

Attachment 13 (cont'd)

Recommendation C

The DCAA Branch Manager, South Bay Branch Office should:

1. Provide training to the audit staff on CAS 401, including CAS 401-4, "Requirements," and CAS 401-60, "Illustrations."
2. Take corrective action to ensure that the audit staff examines any estimates of direct labor costs included in price proposals submitted by [REDACTED] compliance with CAS 401 and consider the illustration of a cost accounting practice deemed not to be consistent at CAS 401-60(b)4.
3. Perform an audit of the contract action resulting from the negotiation of the [REDACTED] \$119,516,041 firm-fixed price Inter-organizational Work Authorization proposal for [REDACTED] Multi-Year II Update (Plus Option 60) to ensure that the price paid by the U.S. Government for work estimated and proposed by [REDACTED] was not increased due to any failure on the part of [REDACTED] to comply the requirements of CAS 401.

Finding D. DCAA requested DCMA technical assistance without testing the [REDACTED] data

DCAA did not comply with DCAA audit policy provided in the DCAA Contract Audit Manual, Appendix D, "Technical Specialist Assistance"³ when it requested technical assistance from the Defense Contract Management Agency in its audit of the proposed labor hours included in the December 16, 2011, [REDACTED] Inter-Organizational Work Authorization proposal.

DCAM D-201 provides that "Requests for technical assistance should be very specific to avoid miscommunication and improve the probability of obtaining meaningful evaluations." The DCAA working papers did not demonstrate that DCAA complied with the DCAA Contract Audit Manual Appendix D as follows.

- DCAA did not perform tests of the underlying [REDACTED] historical labor hours provided to the specialist, as required by DCAM at D-101(d), which provides that "the auditor is required to make appropriate tests of accounting data provided to and used by the specialist."
- DCAA did not perform tests to determine that the labor estimating techniques proposed by [REDACTED] to estimate labor hours, including the improvement curve technique and labor cost estimating relationships, were appropriate under the

³ The DCAA Contract Audit Manual (DCAM) Appendix D, Section D-001, "Scope," provides audit guidance to assist the auditor "in (1) deciding if technical specialist assistance is needed, (2) identifying the specific type of assistance needed, (3) requesting the assistance, (4) achieving good communications with technical specialist, (5) assessing the impact of technical specialist findings upon the audit opinion, and (6) reporting on the use of technical specialists or the impact of their non-availability." The DCAM is available on DCAA website at <http://www.dcaa.mil/> under Publications.

Attachment 13 (cont'd)

circumstances, as required by DCAM D-102.1(c). DCAM D-102.1(c) provides that “if the labor estimating techniques used is based on historical data, determine if its use is appropriate or whether another technique (e.g., one based on industry production standards) should be used for greater estimating accuracy/reliability.” DCAM D-102.1(c) provides procedures for determining appropriateness, including:

- identifying the historical data used to develop the labor cost estimate,
- ascertaining the reliability and accuracy of the data,
- evaluating the content of the data to ensure that it is representative and contains all costs that are purported to be there,
- Making sure the data is current, and
- drawing a conclusion regarding the suitability of historical data for making estimates.

Recommendation D

The DCAA Branch Manager, South Bay Branch Office, should provide the audit staff with training on the requirements of DCAM Appendix D and should implement procedures that ensure that the auditors make appropriate tests of contractor data provided to and used by the DCMA technical specialist.

Concluding Remarks

We do not require a formal written response from DCAA at this time. We plan to issue a formal draft report covering the results of multiple high-risk oversight reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on factual matters discussed in this memorandum in advance of the report.

If you have any questions, please contact the undersigned or [REDACTED] at [REDACTED] or by email at [REDACTED]

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Carolyn R. Davis
Assistant Inspector General
Audit Policy & Oversight

Attachment 14



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

June 21, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
FIELD DETACHMENT

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment No. 09891-2006G10100003 (APO HRR Memorandum No. 14, Project No. D2013-DAPOCF-0004.002)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 09891-2006G10100003, involving an audit of a contractor's claimed incurred cost for 2006. Our review of the audit assignment disclosed that the FAO did not:

- adequately document the audit risk and budgeted hours relative to Dollars Examined¹; or
- report the actual Dollars Examined in the DCAA Management Information System.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 09891-2006G10100003 as part of this effort.

Under the assignment, the field audit office (FAO) examined the contractor's January 31, 2008, intermediate home office allocation proposal for reimbursement of 2006 incurred costs. The FAO performed the examination to determine the allowability, allocability, and reasonableness of the incurred costs. On February 28, 2013, the FAO reported an upward adjustment of \$1,359,298 to the proposed incurred costs.

Objective and Scope of High-Risk Review

We reviewed Assignment No. 09891-2006G10100003 to determine if the FAO:

¹ "Dollars Examined" represents contractor costs claimed on Government flexibly priced contracts for which the auditor can express an opinion as to reasonableness, allocability and allowability. Dollars Examined are entered into the DCAA Management Information System for incurred cost and several other types of audits.

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Attachment 14 (cont'd)

- correctly applied appropriate criteria, such as the Federal Acquisition Regulations (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and Cost Accounting Standards (CAS);
- followed key Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, made inquiries to FAO personnel, and reviewed other relevant documents. We did not perform a comprehensive review of the assignment for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of the assignment disclosed that the FAO did not (1) adequately justify the budgeted and incurred hours, and (2) overstated “Dollars Examined” in the DCAA Management Information System.

Inadequately Documented Audit Risk and Budget Increases

The Branch Office incurred 1,245 hours to cover approximately \$1.6 million in “Dollars Examined.” This equates to auditing \$1,310 for each audit hour incurred, significantly lower than the Agency average of \$32,800 for FY 2011 and \$20,100 for FY 2012. Therefore, under this assignment, the FAO examined far less claimed dollars per audit hour than the Agency average.

We recognize that the hours necessary to adequately cover an assignment objective must depend on a variety of risk factors and circumstances, not just Dollar Examined. However, the hours planned and incurred on an assignment should bear some relationship to the audit risk documented by the auditor during the planning stage and throughout the audit. In this case, the working papers do not adequately explain why the FAO chose to expend the extraordinary resources it did to complete the audit relative to the Dollars Examined. For example, the risk assessment portion of the working papers did not identify any unusual risk factors that might have helped to support the effort expended.

We noted that the auditor and supervisor established an original budget of 313 hours, but the budget was ultimately increased to 1,245 hours (nearly a 300 percent increase). Although the auditor submitted written requests for budget increases, which the supervisor approved, the requests do not provide a sufficient explanation for the increases. The auditor documented the following explanations for the increases:

Attachment 14 (cont'd)

- starting and stopping the audit for other priority work;
- performing an adequacy review of the contractor's proposal;
- incorporating assist audit results;
- finishing the report and working papers; and
- incorporating any required adjustments to the report and working papers.

Generally, the original budget already incorporated hours for these tasks. The supervisor should have required the auditor to better describe the circumstances which necessitated the requested increase, and ensure that the increase was commensurate with the documented risk factors.

In addition, we also found that the auditor had already incurred a significant portion of the budget increases prior to submitting them for approval. The supervisor needs to review requested increases in advance to help ensure that the auditor does not expend any misdirected or unnecessary effort.

Finally, we learned that the FAO has not established procedures or guidelines for submitting and approving proposed budget increases. The FAO should establish such procedures to help ensure that auditors document adequate rationale for increases prior to incurring the hours, and supervisors consider whether the additional hours are commensurate with the overall audit risk.

Dollars Examined Were Overstated in the DCAA Management Information System

The FAO input Dollars Examined of approximately \$2.8 million for Assignment No. 09891-2006G10100003 into the DCAA Management Information System. However, the actual Dollars Examined was \$1.6 million after excluding fringe benefits and executive salaries that the auditor did not review under this assignment. The same FAO audited these costs under another assignment as part of the contractor's divisional incurred cost proposal. Accordingly, the FAO needed to include these costs as Dollars Examined under the divisional assignment. Dollars Examined must be accurate because DCAA uses it to help determine the appropriate allocation of resources. When Dollars Examined is overstated, it might contribute to the FAO using too many resources for a particular assignment objective (in this case, the objective of auditing the contractor's intermediate home office allocation proposal).

When computing Dollars Examined, DCAA policy requires the FAO to exclude allocations (such as fringe benefits) only when another FAO has cognizance over the allocations. DCAA DMIS Manual, Appendix A, Section II, paragraph C.1.(e) states:

Attachment 14 (cont'd)

Dollars examined will not include costs related to (i) assist audits requested, (ii) allocations from home office, corporate, or group, etc., under the cognizance of another DCAA audit office...

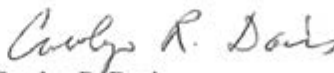
Dollars Examined for a particular assignment should reflect the amounts being evaluated and reported on under that assignment, even when audit cognizance for allocated costs resides in a separate assignment of the same FAO. This will help to ensure the appropriate allocation of resources for a particular audit objective. DCAA needs to revise the policy to require the exclusion of all allocations not audited under the assignment, regardless of whether or not audit cognizance resides with another FAO.

Recommendations

1. We recommend that the Director, Defense Contract Audit Agency, direct the Director, Field Detachment to develop FAO procedures or guidelines to help ensure that:
 - a. auditors adequately document rationale for significant budget increases prior to incurring the hours, and
 - b. supervisors consider whether the requested hours are commensurate with the overall audit risk.
2. We recommend that the Director, Defense Contract Audit Agency revise the DCAA Management Information Systems procedures to require that Dollars Examined exclude cost allocations audited under a separate assignment, regardless of whether or not audit cognizance resides with another FAO.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED]


Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 15



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

June 21, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY MID-ATLANTIC REGION

SUBJECT: Results of High Risk Review (HRR) Regarding Audit Assignment
No. 6341-2005C10100010 (APO HRR Memorandum No. 15, Project No.
D2013-DAPOCF-0004.002)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 6341-2005C10100010, involving the audit of a contractor's claimed FY 2005 incurred costs. Our review of the audit assignment disclosed the following deficiencies:

- Inadequate audit planning for a substantial budget increase;
- Insufficient support for the auditor's transaction testing plan;
- Lack of evidence regarding supervisory involvement;
- Improperly superseded working papers; and
- Inaccurate calculation of the penalty participation rate.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk." (Also referred to as high-risk reviews) We selected the assignment as part of this high-risk review effort.

Under the assignment, the DCAA Southern New Jersey Branch Office examined a DoD contractor's January 27, 2012, indirect cost rate proposal for reimbursement of FY 2005 incurred costs. The Branch Office performed the examination to determine the allowability of direct and indirect costs and establish audit-determined indirect cost rates for FY 2005. On September 26, 2012, the Branch Office reported questioned costs of \$7,838 and \$22,791 for claimed travel and general and administrative costs, respectively. The Branch Office also unresolved \$2.6 million of claimed subcontractor costs.

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the Branch Office:

- correctly applied appropriate criteria such as the Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Cost Accounting Standards;

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Attachment 15 (cont'd)

- followed Agency procedures and guidance;
- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package, interviewed appropriate DCAA employees, and reviewed other relevant documents. We did not perform a comprehensive review of the assignment for compliance with all generally accepted government auditing standards.

Results of High Risk Review

Inadequate Planning Associated With a Substantial Budget Increase

The Branch Office incurred 2,244 audit hours to cover approximately \$29 million in Dollars Examined¹. This equates to approximately \$12,923 for each audit hour reviewed, significantly lower than the Agency average of \$32,800 for FY 2011 and \$20,100 for FY 2012. Therefore, under this assignment, the FAO examined far less claimed dollars per audit hour than the Agency average.

We recognize that the hours necessary to adequately cover an assignment objective must depend on a variety of risk factors and circumstances, not just Dollar Examined. However, the hours planned and incurred on an assignment should bear some relationship to the audit risk documented by the auditor during the planning stage and throughout the audit. In this case, the working papers do not adequately document why the Branch Office chose to expend the extraordinary number of hours it did to complete the audit. Although the audit risk was set at “maximum,” it did not describe any special circumstances or risk factors that the Branch Office considered.

The auditor and supervisor had established an original budget of 600 hours to complete the assignment. Although the supervisor subsequently increased the budget to 2,244 hours (a 274 percent increase), the working papers contain no evidence that the auditor asked for the increase or explained why it was necessary to accomplish the audit objective. In addition, the auditor did not modify the audit program to cover the work that would be performed under the increase. The auditor told us she verbally discussed the need for the budget increase with her supervisor, and the supervisor revised the budget based on that discussion.

Generally Accepted Government Auditing Standard 6.06 states, “Auditors must adequately plan and document the planning of the work necessary to address the audit objectives.” Assignment No. 6341-2005C10100010 does not comply with this standard because

¹ “Dollars Examined” represents contractor costs claimed on Government flexibly priced contracts for which the auditor can express an opinion as to reasonableness, allocability and allowability. Dollars Examined are entered into the DCAA Management Information System for incurred cost and several other types of audits.

Attachment 15 (cont'd)

the FAO working papers fail to properly document that the auditor had planned the work she intended to accomplish under the budget increase. The Agency needs to provide training to the FAO audit staff addressing the requirement for adequately planning and documenting the work to be accomplished under a significant budget increase.

We found that neither the Southern New Jersey Branch Office nor the Agency as a whole has procedures or guidelines for documenting significant budget increase requests. As reported in High Risk Review Memorandum No. 14, we found that another FAO had not adequately documented the need for a substantial budget increase. At a minimum, DCAA should develop guidelines for handling significant budget increases to help ensure that FAOs consistently document the request, need, and approval of those increases.

Inadequate Support for the Transaction Testing Plan

For all overhead pools except the General and Administrative pool, the FAO only performed detailed transaction testing of claimed fringe-benefit costs (consisting of employee insurance premiums, statutory employee-related taxes, and employee savings plans). The auditor took no exception to the claimed fringe benefit costs. The working papers do not adequately explain why the auditor chose only this account for transaction testing. The working papers simply state that the auditor selected fringe benefit related costs based on the “high-risk and high dollar amounts.” They fail to document why fringe benefit costs involved “high-risk,” other than to point out their relative dollar value. We noted that the claimed fringe benefit costs for 2005 were fairly consistent with those claimed in the prior year, and the FAO did not question any prior-year costs. Other claimed overhead accounts, such as the contractor’s “miscellaneous” account and others having no nomenclature, might have involved a higher degree of overall audit risk even though their dollar value was smaller. Therefore, the working papers did not adequately demonstrate that the auditors considered and documented all relevant forms of risk in selecting the fringe benefits account.

DCAA needs to provide the FAO with training on properly documenting the basis for the auditor’s transaction testing plan. The training should cover the various forms of risk that the auditor must consider and describe in developing the plan.

Insufficient Evidence of Supervisory Guidance

Our review of the working papers disclosed insufficient evidence of appropriate supervision being provided throughout the audit. The lack of adequate supervision likely contributed to the deficiencies discussed above regarding the failure to plan the work and demonstrate the appropriateness of the transaction testing plan. Generally Accepted Government Auditing Standards (GAGAS), paragraph 6.54 – states:

Audit supervision involves providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable requirements, while staying informed about significant problems encountered, reviewing the work performed and providing on the job training.

Attachment 15 (cont'd)

In particular, we found essentially no evidence of supervisory involvement during the fieldwork stage. We expected to see more documented evidence of supervisor and branch manager involvement, especially while the auditor apparently encountered significant problems and had to request a 274 percent increase in budgeted hours. The supervisor had an obligation to formally document his review of the increase to ensure that the auditor did not expend any misdirected or unnecessary effort. The working papers should have also demonstrated more supervisor oversight and review of the detailed transaction testing plan to ensure it adequately considered all relevant forms of risk to the Government.

DCAA should provide training to the entire FAO audit staff covering the need to properly document the supervision of an audit.

Superseded Working Papers

While the assignment was in progress, one of the assigned auditors left the Agency (hereafter referred to as the prior auditor). The prior auditor had charged 517 hours to the assignment. The lead auditor who completed the assignment did not supersede the prior auditor's working papers in accordance with DCAA procedure. DCAA Contract Audit Manual 4-403f (2) states:

Superseded working papers should be clearly identified as such and include any working papers prepared during the course of the audit that do not support or are not relevant to the conclusions in the audit report. This will include, for example, working papers changed due to revisions in audit methodology that are not relevant to the audit conclusions.

The lead auditor decided that the prior auditor's working papers did not support the reported conclusions. However, she left them in the "current" section of the working papers (the section used to support the reported conclusions), and added a note that read in part:

...Work papers are being recreated to provide more adequate and accurate documentation related to transaction testing and sampling procedures utilized.

In accordance Agency procedure, the lead auditor needed to clearly label the working papers as superseded and move them to the superseded working paper section. The FAO audit staff should be provided with training on how to properly supersede working papers.

Inaccurate Penalty Participation Rate

The FAO incorrectly computed a general and administrative penalty participation rate of 16.74 percent. The FAO incorrectly calculated the rate because the auditor failed to:

- include costs subject to penalty on flexibly-priced contracts completed in 2005; and
- exclude certain costs not subject to penalty on time and material contracts.

Attachment 15 (cont'd)

After adjusting for these errors, we calculated a 20.66 percent penalty participation rate. We provided detailed calculations of the 20.66 percent rate to the FAO manager. We are not requesting that the FAO supplement the report to correct the rate because, in this case, the errors did not result in significant recommended penalty differences. However, the FAO should be provided with training on the proper calculation of penalties.

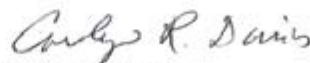
Recommendations

1. We recommend that the Director, Defense Contract Audit Agency direct the Regional Director, DCAA Mid-Atlantic Region to provide training to the Southern New Jersey Branch Office in the following areas:
 - a. Required planning and documentation efforts for significant budget increases.
 - b. Consideration of applicable risk factors in developing the transaction testing plan.
 - c. Documentation of supervisory involvement and guidance.
 - d. Retention of superseded working papers.
 - e. Calculation of penalty participation rates.
2. We recommend that the Director, Defense Contract Audit Agency develop guidelines for requesting significant budget increases to help ensure that FAOs consistently document the request, need, and approval of the increases.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the factual matters discussed in this memorandum in advance of the draft report.

We appreciate the courtesies extended to my staff. If you have any questions, please contact [REDACTED] or [REDACTED]



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 16



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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June 21, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT
AGENCY EASTERN REGION

SUBJECT: Results of High Risk Review Regarding Audit Assignment No. 1261–
2007J10100537 (APO HRR Memorandum No. 16, Project No. D2013-DAPOCF-
0004.002)

This memorandum sets forth the results of our review of Defense Contract Audit Agency (DCAA) Assignment No. 1261–2007J10100537, involving DCAA Alabama Branch Office's audit of an incurred cost submission of a DoD contractor. Our review disclosed that the completion of the assignment was significantly delayed and the auditor did not document the reason for the delay in the working papers. In addition, the auditor included 23 pages of detailed explanatory notes in the report which do not appear to serve a useful purpose.

Background

As part of our continuous oversight of DCAA, we initiated an effort to periodically select and review audit assignments performed in areas we identified as "high risk" (also referred to as high-risk reviews). We selected DCAA Assignment No. 1261–2007J10100537 as part of this high-risk review.

Under the assignment, the DCAA Alabama Branch Office examined the 2007 incurred cost submission of a DoD contractor. The purpose of the examination was to determine the allowability of direct and indirect costs and recommend to the contracting officer-audit determined indirect cost rates for the period January 1, 2007 through December 31, 2007. In a January 31, 2013, report, the field audit office (FAO) took no exception to the claimed indirect rates and qualified the claimed subcontractor costs.

Objective and Scope of High-Risk Review

We reviewed the assignment to determine if the FAO:

- correctly applied appropriate criteria, such as the Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, Cost Accounting Standards, and the contract terms;
- followed key Agency procedures and guidance;

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Attachment 16 (cont'd)

- gathered sufficient evidence in support of the reported findings and recommendations; and
- issued an audit report that adequately described the findings and recommendations and served a useful purpose to the contracting officer.

To accomplish the objective, we obtained a copy of the assignment working paper package and reviewed the audit package and other relevant documents. We did not perform a comprehensive review of Assignment No. 1261–2007J10100537 for compliance with all generally accepted government auditing standards.

Results of High-Risk Review

Our review of Assignment No. 1261–2007J10100537 disclosed the following two issues:

Significant Delay in Completing the Assignment

The FAO took 4 years to complete the assignment after holding the entrance conference and initiating fieldwork on January 21, 2009. DCAA Contract Audit Manual (CAM) 6-707.4, states, “It is DCAA policy that all indirect cost submissions will be audited as promptly as practical after receipt of the contractor's proposal.” When DCAA significantly delays its completion of an incurred cost audit, other critical contracting actions are impacted. For example, contracting officers cannot close most flexibly-priced contracts because final rates are not available. Contract funding can also expire as a result of DCAA failing to complete an incurred cost audit within a reasonable period of time.

The FAO manager told us Assignment No. 1261–2007J10100537 was delayed to focus on “higher-priority” work. However, there was no indication in the working papers that the audit had been significantly delayed for other priority work. In fact, the auditor continued to charge the assignment intermittently over the entire 4-year period. The working papers needed to provide an explanation of why the audit was significantly delayed. The FAO should develop a policy to help ensure that auditors document the reasons for significant delays in the working papers.

Unnecessary Explanatory Notes in the Audit Report

The FAO included 23 pages of explanatory notes in the audit report even though the auditor took no exception to any of the claimed costs. We question the necessity of preparing extensive explanatory notes in this case because the contracting officer did not need to negotiate any questioned costs. The FAO might have saved substantial, scarce audit resources by omitting from the report any unnecessary details concerning proposed cost, scope, and conclusions of each audited cost element. In total, the auditor charged 1,906 hours to audit only \$85 million in

Attachment 16 (cont'd)

Dollars Examined¹. While we do not know how many of these hours were expended to prepare the 23 pages of detailed explanatory notes, the hours saved in not including them could have been significant.

The FAO manager told us the Agency's "preference" is to include detailed explanatory notes in the report even when the auditor takes no exception to the claimed costs. CAM 10-210.6(a), "Explanatory Notes," states:

Explanatory notes may be omitted in audit reports where there are no findings and the requestor has indicated that the information describing the basis of the cost and the audit evaluation would not be useful at negotiations.

The FAO did not meet with the requester to determine if explanatory notes would be useful in this case. The CAM guidance should be clarified to convey that FAOs need to meet with the requester to discuss whether detailed explanatory notes would serve a useful purpose when there are no findings. It should also require that the auditor document the discussion in the working papers.

Recommendations

1. We recommend that the Regional Director, Defense Contract Audit Agency Eastern Region, require that the Alabama Branch Office Manager implement a procedure for helping to ensure auditors document the reasons for significant assignment delays in the working papers.
2. We recommend that the Director, Defense Contract Audit Agency, revise Contract Audit Manual 10-210.6(a) to clarify that auditors should:
 - a. coordinate with the requester when there are no findings to determine if inclusion of detailed explanatory notes would serve a useful purpose, and
 - b. document the coordination in the working papers.

Closing Remarks

We plan to issue a formal draft report covering the results of multiple high-risk reviews, including this review. We will request a formal written response from DCAA once we issue the draft report. However, we welcome any informal comments on the matters discussed in this memorandum in advance of the draft report.

¹ "Dollars Examined" represents contractor costs claimed on Government flexibly priced contracts for which the auditor can express an opinion as to reasonableness, allocability and allowability. Dollars Examined are entered into the DCAA Management Information System for incurred cost and several other types of audits.

Attachment 16 (cont'd)

We appreciate the courtesies extended to my staff. If you have any questions regarding this memorandum, please contact either [REDACTED] or [REDACTED]



Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

Attachment 17

Management Comments and Our Response To Recommendation 1

DCAA agreed with 63 and disagreed with 24 of the recommendations contained in Attachments 2, 3, 5, 8, 9, 10, 11, 13, 14, 15, and 16. See Attachment 18 for the complete text of the DCAA comments.

For the recommendations that DCAA agreed with, DCAA comments were fully responsive and no additional comments are required. For 21 of the 24 recommendations that DCAA did not agree with, we request that DCAA provide additional comments. No additional comments are required for the remaining three recommendations (see Note 5). The following table depicts the number of recommendations that DCAA agreed or disagreed with for each memorandum. The associated notes provide a summary of the management comments for each recommendation that DCAA disagreed with and our response to those comments.

Table. Number of Agreed and Disagreed Recommendations

Memorandum/Attachment No.	Agreed	Disagreed	Note
Memorandum No.2	4	4	1
Memorandum No.3	2	1	2
Memorandum No.5	21	1	3
Memorandum No.8	1	6	4
Memorandum No.9	3	0	
Memorandum No.10	4	3	5
Memorandum No.11	19	2	6
Memorandum No.13	4	6	7
Memorandum No.14	1	1	8
Memorandum No.15	2	0	
Memorandum No.16	2	0	
Total	63	24	

Note 1 - DoDIG Memorandum No.2 on Audit Assignment No. 3141-2011M21000001

DCAA Comments

DCAA disagreed with Recommendations A.1, C.1, C.2, and E.1 included in Memorandum 2 (Attachment 2). DCAA stated that the contractor did not provide the requested actual costs because the contractor was (1) “not required to maintain costs in detail under the firm-fixed price undefinitized contract action,” and (2) “not required to segregate actual costs due to the lack of a Change Order Accounting Clause on the fixed-price Undefinitized Contract Action.”

Our Response

The DCAA auditor had not observed that the contractor had completed production of all 250 vehicles prior to submitting its proposal. FAR 15.408, Table 15-2, Part I requires the contractor to identify incurred costs for work performed before submitting a proposal. All of the work was performed before the submission of the proposal, and the auditor failed to ensure that the contractor had complied with the FAR in disclosing all incurred costs.

Note 2 - DoDIG Memorandum No. 3 on Audit Assignment No. 4551-2009B11010001

DCAA Comments

DCAA disagreed with Recommendation 2 included in Memorandum 3 (Attachment 3). DCAA stated that the testing period covered by the audit report ended May 2010, and the FAO continued to find similar deficiencies in its voucher reviews up to and beyond the report issuance date. DCAA stated that these deficiencies continued to result in overbilled costs to the Government, and that implementing this recommendation would inappropriately put the Government at risk of improperly paying the contractor.

Our Response

The contracting officer elected not to suspend progress payments as DCAA recommended. Therefore, the Government will not be subjected to any increased risk as a result of removing the reported recommendation.

DCAA must be able to support any reported recommendations with evidence of timely and relevant testing. The contractor billings tested by DCAA and addressed in the report were between 18 months and 4 years old when DCAA issued its report in

November 2011. Therefore, the testing was outdated and did not necessarily reflect the contractor's billing system as of November 2011. The working papers supporting this report did not include any more current voucher reviews that would support a recommendation to suspend contractor payments. Accordingly, DCAA must supplement the report and remove the recommendation to suspend contractor payments.

If the FAO has performed more current tests not addressed in the subject report, it should report on the results of those tests in another report and recommend the suspension of progress payments if those tests support such a recommendation.

Note 3 - DoDIG Memorandum No.5 on Audit Assignment No. 6341-2011D21000009

DCAA Comments

DCAA disagreed with Recommendation C.3 included in Memorandum 5 (Attachment 5). DCAA concluded that a subsequent audit of the contractor's compliance with CAS on this contract is not needed because DCAA did not opine on direct labor costs in the report.

Our Response

DCAA did opine on direct labor and indicated in the working papers that it had evaluated proposed labor hours for compliance with CAS. DCAA provided positive assurance in its audit opinion that the contractor's proposal, including proposed direct labor, was in compliance with CAS. However, regarding direct labor, DCAA did not perform sufficient procedures to support an audit opinion on CAS compliance. The audit performed by DCAA does not provide reasonable assurance that the 463,969 proposed manufacturing hours and 149,557 proposed engineering hours complied with the requirements of the CAS.

Note 4 - DoDIG Memorandum No.8 on Audit Assignment No. 4411-2005X10100017

DCAA Comments

DCAA disagreed with Recommendations 1, 2, 3, 4, 6 and 7 included in Memorandum 8 (see Attachment 8). Regarding Recommendations 2, 3, 4, and 6, DCAA stated it performed the following alternative procedures that satisfied the audit objectives for various Mandatory Annual Audit Requirements (MAARs):

- For MAAR 6, the auditor reconciled the claimed labor cost to the books and records, reviewed executive compensation, and transaction-tested the legal cost account;
- For MAAR 10, the adjusting journal entries had an opportunity to be selected for review as part of transaction testing;
- For MAAR 15, the auditor compared claimed costs by account to prior year costs; and
- For MAAR 9, the auditor reconciled payroll to the contractor's California state tax return.

Regarding Recommendations 1 and 7, DCAA stated that supplementing the report was not necessary because it performed the alternative procedures which satisfied the audit objectives.

Our Response

The alternative procedures do not satisfy the audit objectives for the reasons discussed below:

- Regarding MAAR 6, the alternative procedures did not test the reliability of the employee time records, ensure employees existed, or verify employees were working;
- Regarding MAAR 10, the working papers do not demonstrate that the auditor planned to review or reviewed any adjusting journal entries as part of transaction testing;
- Regarding MAAR 15, the alternative procedure did not include a comparison of claimed to budgeted costs, which could have identified high-risk areas (for example, cost shifting); and
- Regarding MAAR 9, the auditor's reconciliation to the California state tax return does not satisfy the audit objective because it does not include a reconciliation of federal taxes as required by MAAR 9.

Therefore, as we addressed in Recommendations 1 and 7, DCAA should supplement the audit report once it performs the additional procedures to satisfy the audit objectives.

Note 5 - DoDIG Memorandum No. 10 on Audit Assignment No. 2701-2012C21000001

DCAA Comments

DCAA disagreed with Recommendations A.1, A.2 and A.3 included in Memorandum No. 10 (Attachment 10), pointing out that the revised policy in DFARS 215.408 and DFARS 252.215-7009 should help prevent the receipt and audit of inadequate price proposals.

Our Response

Although DCAA did not agree, the management comments are responsive and we do not require additional comments. The revised DFARS policies should help prevent reoccurrences.

Note 6 - DoDIG Memorandum No. 11 on Audit Assignment No. 4821-2011R21000012

DCAA Comments

DCAA disagreed with Recommendation E and F.1.a included in Memorandum No. 11 (Attachment 11). Regarding Recommendation E, DCAA stated that it expects auditors to be involved in post-audit report walkthroughs and technical fact finding summits. For Recommendation F.1.a, DCAA stated that it is appropriate to report dollars examined, questioned costs and net savings even when DCAA did not evaluate the contractor's proposed rates. The agency stated it complied with current agency policy, and the policy provides reasonable assurance that the data will be correctly reported.

Our Response

We disagree with DCAA regarding Recommendation E. The extraordinary actions taken by the Army after receipt of this audit report cannot be classified as normal post-audit discussions between the auditor and contracting officer. The actions taken by the Army contracting officer to convene a 'summit' at the DCAA office in Arizona from February 6 through 24, 2012, in order to reconcile the gaps in the audit findings and make the audit report useable for negotiating the contract went far beyond normal post-audit discussions. The fact that the Army contracting command subsequently implemented a requirement for post-audit report 'summits' for all DCAA audit reports received on proposals exceeding \$500 million should indicate a strong need for DCAA to take responsive action on our recommendation.

Regarding Recommendation F.1.a, DCAA policy should not allow reporting of dollars examined, questioned costs and net savings generated by work performed by another agency. For example, DCAA should not report net savings that are the direct result of the Defense Contract Management Agency's review of forward pricing indirect rates.

Note 7 - DoDIG Memorandum No. 13 on Audit Assignment No. 4421-2012B21000001

DCAA Comments

DCAA did not concur with six recommendations included in Memorandum No. 13 (Attachment 13). DCAA disagreed with Recommendations B.1, B.2, and B. 3, stating it had obtained sufficient evidence to support the audit opinion on proposed material costs. DCAA also disagreed with Recommendation C.1, C.2, and C. 3, stating that they were able to demonstrate the contractor's compliance with CAS 401 because the standard allows for the accumulation of costs in greater detail than proposed.

Our Response

Regarding Recommendations B.1, B.2, and B.3, DCAA provided additional information during the review. We reviewed the additional information and maintain that the auditors did not obtain sufficient evidence to support the audit opinion. The auditor relied on unsigned purchase contracts and long term agreements originating from the contractor and not from the supplier. The auditor should have obtained independent, credible evidence from the supplier when determining the allowability of proposed material cost.

As for Recommendations C.1, C.2, and C. 3, we disagree with DCAA. Their interpretation of CAS 401 oversimplifies the standard and does not take into consideration the illustration of an inconsistent cost accounting practice as identified at subsection 9904.401-60(b)4. Additionally, DCAA's contention that CAS 401 allows for the accumulation of costs in greater detail than proposed does not explain the differences between the DCAA-identified labor categories found in (1) the contractor's estimate of costs, (2) the contractor's disclosure statement and, (3) the contractor's recorded labor hours.

Note 8 - DoDIG Memorandum No.14 on Audit Assignment No. 9891-2006G10100003

DCAA Comments

DCAA did not concur with Recommendation 2 of Memorandum No. 14 (Attachment 14). DCAA stated that it did not duplicate Dollars Examined in DMIS, and that dividing the incurred cost submission among different teams saves time when auditing identical cost elements incurred by related contractor entities.

Our Response

We did not state that the FAO had duplicated Dollars Examined, and we did not question the FAO's decision to divide the audit of the incurred cost submission among different teams. We reported that DCAA overstated Dollars Examined in assignment 9891-2006G10100003 and understated Dollars Examined in another assignment by the same amount. Therefore, DCAA incorrectly reported Dollars Examined under both assignments. Our concern rests with the fact that the FAO did not accurately report Dollars Examined associated with each audit assignment, and doing so could result in the inappropriate allocation of audit resources to each audit objective for future years.

Attachment 18



DEFENSE CONTRACT AUDIT AGENCY

OFFICE OF THE DIRECTOR
8728 JOHN J. KINGMAN ROAD, SUITE 213B
FORT BELVOIR, VA 22060-6219

June 13, 2014

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL, POLICY AND
OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

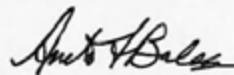
SUBJECT: Response to Office of Inspector General Department of Defense, Draft Report,
Review of Audits Issued by the Defense Contract Audit Agency in FY 2012 and
FY 2013 (Project No. D2013-DIPOAC-0004.000)

Thank you for the opportunity to review and respond to the findings and recommendations presented in the subject draft report *Review of Audits Issued by the Defense Contract Audit Agency in FY 2012 and FY 2013*, issued on March 11, 2014. We take your results seriously and have taken corrective actions to address many of the findings. We continue to build and strengthen our organization to provide independent, objective and thorough audits.

The subject draft report contains three recommendations and numerous recommendations in the 16 attachments (each attachment presents the results of the DODIG review of a DCAA assignment). Three of the 16 attachments had no recommendations. We concur and/or concur in principle with the majority of recommendations in the subject draft report. We have completed or are taking action on the recommendations with which we concur.

Enclosed is our response to your findings and recommendations.

Questions regarding this memorandum should be directed to [REDACTED]


Patrick J. Fitzgerald
Director

Enclosure

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DCAA appreciates the opportunity to respond to the report and memoranda (Attachments).

DODIG Draft Report

DoDIG Recommendation 1: Provide written management comments of the findings and recommendations contained in Attachments 2, 3, 5, 8, 9, 10, 11, 13, 14, 15, and 16.

DCAA Response: Concur.

DCAA's response to all of the recommendations in the report and memoranda (Attachments 1 through 16) follow.

DoDIG Recommendation 2: Deliver training to all audit staff on the proper handling of superseded working papers.

DCAA Response: Concur in principle.

We agree that all auditors should be aware of how to properly handle superseded working papers, but we do not believe the finding in this report indicates a systemic problem. The incidents identified are isolated (Attachments 1 and 15) and do not warrant the cost of implementing training beyond what we already have in place. Specifically, DCAA's Computer Managed Training Library (CMTL) 1269-Working Paper Documentation which is required training for all DCAA auditors. Additionally, guidance on handling superseded working papers is addressed in DCAA Contract Audit Manual (DCAM) 4-403f. We believe that the current training and guidance sufficiently addresses the recommendation.

DoDIG Recommendation 3: Improve the reliability and accuracy of recommended penalties by:

- a. providing training to all audit staff covering the computation of recommended penalties; and
- b. assessing the adequacy of, and make improvements to, existing Defense Contract Audit Agency policies and procedures to help ensure auditors correctly compute recommended penalties in accordance with FAR 42.709.

DCAA Response: Concur.

In an effort to better define what costs are expressly unallowable and subject to penalties, DCAA has undertaken a project to analyze each cost principle. The intent is to ensure a consistent understanding of what cost principles are expressly unallowable. The results of this project should eliminate any inconsistent treatment of expressly unallowable costs and improve the accuracy of what costs are subject to penalties and the computation of recommended penalties. Once the comprehensive review and analysis is complete, we plan to provide training to the staff

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

on the results of the project and integrate into the training coverage on the calculation of recommended penalties.

DoDIG Memorandum No. 1 on Audit Assignment No. 3321-2009K10180035

DoDIG Recommendations: We recommend the Director, Defense Contract Audit Agency direct the Regional Director, DCAA Central Region to:

1. Provide training to all Resident Office audit staff on how to properly tailor the audit scope for the receipt of assist audits and negotiated settlements.
2. Review the Resident Office procedures for reporting questioned costs in DMIS and make appropriate improvements to help ensure the accurate reporting of those costs.

DCAA Response:

Recommendation 1: Concur.

The action to address this recommendation is complete. On April 3, 2012, training was provided to the audit staff on tailoring the audit scope for the receipt of assist audits and not duplicating audit effort.

Recommendation 2: Concur.

The action to address this recommendation is complete. The Field Audit Office Assistant for Quality (FAQ) presented training to the supervisory auditors on accurately reporting the results of audit in DMIS in accordance with Appendix A of the DMIS User's Guide on July 31, 2013.

DoDIG Memorandum No. 2 on Audit Assignment No. 3141-2011M21000001

DCAA Overall Comments

We do not agree with all of the DoDIG's findings and recommendations contained in Memorandum No. 2. The DoDIG findings are based on DCAA not obtaining and auditing detailed actual incurred cost data. As part of our normal audit, DCAA did request, but the contractor did not provide incurred cost to the auditor to examine. The contractor did not provide requested data because they were not required to maintain costs in detail under the firm-fixed price undefinitized contract action. We appropriately rendered an adverse opinion based on the significance of cost or pricing data inadequacies.

DoDIG Recommendation: By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should:

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation A.1: Implement a procedure requiring that the auditors provide positive assurance through inquiry with the contracting officer and contractor that incurred costs have been appropriately included in the contractor's proposal submission in accordance with FAR 15.408, Table 15-2, Part I – General Instructions, paragraph (F).

DCAA Response: Nonconcur.

DCAA's policies and procedures already require that auditors provide positive assurance through inquiry with the contracting officer and contractor that incurred costs have been appropriately included in the contractor's proposal. Those procedures were appropriately followed in this audit assignment. As discussed above, the contractor was not required to segregate actual costs due to the lack of the Change Order Accounting Clause on this fixed-priced Unfixed-price Contract Action (UCA).

DoDIG Recommendation A.2: Provide training to the audit staff regarding DCAA audit policy for issuing audit reports where the contractor has submitted an inadequate proposal, including training on the appropriate use of a disclaimer of opinion.

DCAA Response: Concur.

Although we do not agree with the specific issue leading to recommendation A.1, training was provided to the Chicago Branch Office (CBO) staff related to recommendations A.2, B, and D on September 19, 2012.

DoDIG Recommendation B: By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should provide the audit staff with training on FAR 15.404-2(d), DCAM 1-504 *Access to Records of Contractor*, and DCAM 1-506 *Other Access to Records Issues – Records Destroyed or Not in Condition for Audit* and should implement procedures for audit staff use in documenting and pursuing to completion any future instances of possibly deficient contractor accounting records or potential contractor denial of access to records.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.2.

DoDIG Recommendation C.1: By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office should establish procedures for supervisory auditor use in documenting the satisfactory resolution of any identified potential CAS noncompliances identified in the audit working papers.

DCAA Response: Nonconcur.

DoDIG's reference to "potential CAS noncompliances" relate to an audit lead work paper. The CBO did not pursue the audit lead because the potential CAS 401 noncompliance was not applicable to this fixed price UCA without the Change Order Clause. The CBO subsequently

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

followed-up on the audit lead and determined the contractor's accounting and estimating practices were compliant. We believe that the current guidance in CAM 3-204 (Factors Influencing the Audit Scope) and audit programs (section B) adequately addresses following up on audit leads in affected audits, therefore we do not agree that CBO should develop its own specific supplemental procedures.

DoDIG Recommendation C.2: By September 30, 2012, the DCAA Regional Audit Manager with cognizance of the Chicago Branch Office should implement quarterly reviews of the Chicago Branch Office. The quarterly reviews should determine whether any reported contractor unsupported costs are the result of a potential contractor denial of access to accounting records and data, and should document for the record the results of each quarterly review.

DCAA Response: Nonconcur.

Procedures already exist which require the DCAA Regional Audit Manager (RAM) to review and discuss significant and sensitive audit issues with the audit team, including those involving significant questioned and unsupported costs and access to records issues. The FAO did not elevate the issue as a denial of access to records because the contractor was not required to segregate the costs as stated above.

DoDIG Recommendation D: By September 30, 2012, the DCAA Branch Manager, Chicago Branch Office, should provide the audit staff with training on the requirements of DCAM Appendix D and should implement procedures that ensure the auditors make appropriate tests of contractor accounting data provided to and used by the DCMA technical specialist.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.2.

DoDIG Recommendation E.1: By August 1, 2012, the DCAA Branch Manager, Chicago Branch Office should:

- a. Rescind DCAA Audit Report No. 3141-2011M21000001, dated October 17, 2011.
- b. Advise the JPO contracting officer of the short-comings included in the audit and that the contracting officer should not rely on DCAA Audit Report No. 3141-2011M21000001, dated October 17, 2011 as a basis for negotiating a fair and reasonable price.
- c. Recommend the JPO contracting officer obtain a new proposal from [REDACTED] that complies with FAR 15.408, Table 15-2, Part I — General Instructions, paragraph (F) and includes [REDACTED] incurred cost for work performed in producing and delivering all [REDACTED]

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

DCAA Response: Nonconcur.

The audit report is accurate and there is no reason or benefit to rescind it. The FAO had sufficient evidence to render an adverse opinion to the contracting officer. The audit report noted that because the cost or pricing data inadequacies were considered to have a significant impact on the proposal taken as a whole, we did not believe the proposal was an acceptable basis for negotiation of a fair and reasonable price. The contracting officer relied on our audit report not to negotiate the contractor's proposal due to the reported inadequacies, and the contractor subsequently submitted a revised proposal, which the contracting officer used to negotiate the UCA.

DoDIG Recommendation E.2: By September 30, 2012, the DCAA Regional Audit Manager with cognizance of the Chicago Branch Office should implement periodic reviews of proposal audit reports issued by the Chicago Branch Office to validate that the reported findings and recommendations are supported by the work performed and documented in the audit working papers.

DCAA Response: Concur in principle.

Procedures already exist which require the RAM to periodically review reports and ensure working papers support the audit report.

DoDIG Memorandum No. 3 on Audit Assignment No. 4551-2009B11010001

DoDIG Recommendation 1: We recommend that the Director, Defense Contract Audit Agency:

- a. Develop policy and guidance on tailoring of audit steps and approaches to audit a business system while a contractor transitions from one system to another.
- b. We recommend that the Director, DCAA perform a review of report preparation and review process at the San Diego field office to ensure compliance with current DCAA policy and to make any other improvements necessary to reduce cycle time between completion of testing procedures and report issuance.

DCAA Response:

Recommendation 1a: Concur.

The action to address this recommendation is complete. On April 24, 2012 audit guidance memorandum 12-PAS-012 (Audit Guidance on Auditing Contractor Business Systems and Contractor Compliance with DFARS 252.242-7006, Accounting System Administration) was issued. This guidance requires auditors to obtain contractor system demonstrations and walk-throughs by contractor personnel during the risk assessment of business system audits. Based on the information obtained during the demonstration and walk-through, auditors design appropriate

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

audit procedure steps to mitigate risk. Contractor's transitioning from one system to another would be part of the information obtained during this process.

Recommendation 1b: Concur.

The action to address this recommendation is complete. On July 31, 2012 the FAO did a lessons learned training session on audit reports not issued timely. The FAO is additionally looking for improvements to reduce overall cycle time.

DoDIG Recommendation 2: We recommend that the Director, DCAA direct the Regional Director, DCAA Western Region, to supplement Audit Report No. 4551-2009B11010001 in order to remove the recommendation for withholding a percentage of contractor payments.

DCAA Response: Nonconcur.

The FAO had sufficient evidence to recommend the contracting officer "pursue suspension of a percentage of progress payments or reimbursement of costs in accordance with DFARS 242.7502." Although the testing period covered by the audit report ended May 2010, the FAO continued to find similar deficiencies in its ongoing voucher reviews up to and beyond the report issuance date. These deficiencies continued to result in overbilled costs and include issues such as i) firm-fixed-price invoices submitted as cost vouchers, ii) vouchers that are unable to be reconciled to the contractor's accounting records, iii) vouchers with incorrect indirect rates, and iv) vouchers with incorrect fees. Since January 2009, the FAO denied payment on hundreds of vouchers returning them to the contractor for correction prior to payment. Based on the continued matters of deficiency, implementing this recommendation would inappropriately put the Government at risk of improperly paying the contractor.

DoDIG Memorandum No. 4 on Audit Assignment No. 6421-2011B19200007

This DoDIG review disclosed no exceptions, findings or recommendations.

DoDIG Memorandum No. 5 on Audit Assignment No. 6341-2011D21000009

DoDIG Recommendation A.1: By January 31, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of FAR 15.404-2 (c)(2)(v) and DCAM 9-204 *Determining Adequacy of Certified Cost or Pricing Data*.

DCAA Response: Concur.

We believe the DoDIG intended to reference FAR 15.404-l(c)(2)(v) instead of FAR 15.404-2 (c)(2)(v) in Recommendation A.1. The action to address this recommendation and recommendations A.2, B.1, B.2, C.1, F.1, and F.2 is complete. Although we do not agree with the specific finding that led to this recommendation, training was provided as part of the annual training plan. Topics addressed at the staff conference held on January 9, 2013 included the items in the seven recommendations.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation A.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements FAR 15.404-1(c)(2)(v) and the audit guidance in DCAM 9-204 when performing price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

DoDIG Recommendation A.3: The DCAA Branch Manager, Southern New Jersey Branch Office, should perform a DCAA defective pricing audit on the contract action resulting from the negotiation of the [REDACTED] to ensure that the negotiated contract price was not increased because the contractor did not submit or disclose accurate, complete, and current certified cost or pricing data.

DCAA Response: Concur.

A defective pricing audit was initiated under audit assignment number 6341-2013D42000003. A copy of the report will be provided to your office upon completion.

DoDIG Recommendation A.4: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items A.1 through 3, above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation and B.3, C.4, D.3, E.3, F.3, and G.2 is complete. The Regional Audit Manager (RAM) for SNJBO was involved in and attended the training related to the findings in this memorandum. In lieu of documenting the RAM review on a quarterly basis for selected assignments, the RAM review of audit reports and involvement in audit assignments is documented in the work paper packages.

DoDIG Recommendation B.1: By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM Appendix D *Technical Specialist Assistance*. The training should cover:

- a. Specific guidance requiring the auditor make appropriate tests of accounting data provided to and used by the specialists as identified at DCAM D-101d,
- b. Specific guidance regarding the actions the auditor should take where it is found the contractor has used a labor estimating technique that is based on historical data as identified at DCAM D-102.1c, and
- c. Specific guidance regarding the actions the auditor should take in determining whether a contractor labor estimating technique based upon the use of historical data is appropriate as identified at DCAM D-205c.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

DoDIG Recommendation B.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the audit guidance in DCAM Appendix D *Technical Specialist Assistance* when performing price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

DoDIG Recommendation B.3: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office to ensure DCAA correctly implements the audit guidance in DCAM Appendix D *Technical Specialist Assistance* and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.4.

DoDIG Recommendation C.1: By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of FAR 15.404-2(c)(2)(iv) and DCAM 8-304 *Audit of Estimated, Accumulated, and Reported Costs to Ascertain Compliance with CAS and FAR*.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

DoDIG Recommendation C.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements FAR 15.404-2(c)(2)(iv) and the audit guidance in DCAM 8-304 when performing price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete. The Branch Manager reinforces correct implementation of FAR 15.404-2(c)(2)(iv) and the audit guidance in CAM 8-304 during monthly meetings with the management staff as well as during the Branch Manager's review of proposal audit reports prior to signature.

DoDIG Recommendation C.3: The DCAA Branch Manager, Southern New Jersey Branch Office, should perform a DCAA CAS compliance audit on the [REDACTED] proposal and Foreign Military Sale [REDACTED] and determine that the [REDACTED] proposal was submitted in compliance with its established and disclosed accounting practices as well as FAR Part 31 and CAS 401 and 402.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DCAA Response: Nonconcur.

The DoDIG concluded that the audit working papers do not demonstrate that DCAA evaluated the historical labor hour data used by the contractor to support its labor hour estimating techniques and determined such historical labor hour data is in reasonable compliance with the contractor disclosed accounting practices and CAS 401 and 402. Since the FAO did not opine on direct labor costs in the report (see pages 1 and 2), there is no need for a review of compliance with CAS 401 and 402 related to the direct labor hours.

DoDIG Recommendation C.4: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion of the actions identified in items C.1 through 2 above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.4.

DoDIG Recommendation D.1: By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM 3-104.14e.

DCAA Response: Concur.

The guidance in CAM 3-104.14e has been moved to CAM 3-204.14e. Training on these requirements will be provided to the audit staff in June 2014.

DoDIG Recommendation D.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 3-104.14e when performing price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete. The Branch Manager reinforces correct implementation of the requirements during monthly meetings with the management staff as well as during the Branch Manager's review of proposal audit reports prior to signature. In addition, management instructs staff on the requirements on an audit by audit basis. (This action also applies to DoDIG Recommendations E.2.)

DoDIG Recommendation D.3: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items D.1 and 2, above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation will be completed. The RAM will attend the training discussed in D.1. Additionally, see response to recommendation A.4.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation E.1: By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on DCAA policy at DCAM 3-104.13.

DCAA Response: Concur.

The action to address this recommendation will be completed. Training on these requirements will be provided to the audit staff in June 2014.

DoDIG Recommendation E.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 3-104.13 when performing price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete See response to recommendation D.2.

DoDIG Recommendation E.3: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office, regarding completion of the actions identified in items D.1 through 3, above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation will be completed. The RAM will attend the training discussed in E.1. Additionally, see response to recommendation A.4.

Recommendation F.1: By January 15, 2013, the DCAA Branch Manager, Southern New Jersey Branch Office, should provide the audit staff with training on the requirements of DCAM 10-210.4 *Qualifications*.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

Recommendation F.2: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure DCAA correctly implements the requirements of DCAM 10-210.4 *Qualifications* when reporting on the results of price proposal audits at the DCAA [REDACTED] location.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.1.

Recommendation F.3: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

of the actions identified in items E.1 and E.2, above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.4.

Recommendation G.1: The DCAA Branch Manager, Southern New Jersey Branch Office, should take corrective action to ensure that audit reports to be issued on contractor price proposals at the DCAA [REDACTED] location are supported by sufficient competent audit evidence.

DCAA Response: Concur.

The action to address this recommendation is complete. The Branch Manager reviews each audit assignment, requiring his signature, for sufficient competent evidence. The actions include sampling audit findings back to supporting documentation and verifying the sufficiency of the evidence in each assignment.

Recommendation G.2: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Southern New Jersey Branch Office regarding completion of the actions identified in items F.1, above, and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur.

The action to address this recommendation is complete. See response to recommendation A.4.

DoDIG Memorandum No. 6 on Audit Assignment No. 2710-2006A10100002

We recommend that the Director, Defense Contract Audit Agency direct the Northeastern Regional Director to:

DoDIG Recommendation 1: Advise the contracting officer that the FAO will supplement the report to correct several reported errors and omissions.

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO notified the Divisional Administrative Contracting Officer (DACO) in Memorandum No. 2013-005, dated January 29, 2013, that a supplemental audit report would be issued addressing items identified by the DoDIG. The Supplemental Audit Report 02701-2006A10100002-S1 was issued April 30, 2013.

DoDIG Recommendation 2: Perform a review of MAAR 5 to identify any other income or credits which the Government might be entitled to receive.

DCAA Response: Concur.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

The action to address this recommendation is complete. The FAO performed additional audit steps relative to MAAR 5 to identify any other income or credits which the Government might be entitled to receive. The results are presented on page 17 of Audit Report No. 2701-2006A10100002-S1.

DoDIG Recommendation 3: Re-examine claimed consultant costs, ensuring that the auditor adequately considers the specific documentation requirements for consultant costs contained in FAR 31.205-33(f).

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO performed additional audit steps relative to claimed consultant costs to determine allowability pursuant to FAR 31.205-33(f). The results are presented on page 21 of Audit Report No. 2701-2006A10100002-S1.

DoDIG Recommendation 4: Prepare and issue a supplemental report in accordance with DCAA CAM 10-214 to:

- a. correct the reported qualifications;
- b. revise the recommended penalties;
- c. remove the Schedule of Claimed Direct Costs by Contract; and if necessary;
- d. incorporate the results of performing the MAAR 5 and re-examining claimed consultant costs (discussed in Recommendation 2 and 3 above).

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO issued Supplemental Audit Report 02701-2006A10100002-S1 dated April 30, 2013 to the DACO, in accordance with DCAA CAM 10-214 that address the IG's recommendations as follows:

- a. included a qualification related to \$4.5 million in unresolved allocation costs; we also included the "except for" language in our results section to reference the qualification for the \$47.9 million unresolved direct costs;
- b. revised the recommended penalties to correct Exhibit A, Note 6 to remove the penalty recommendation on unreasonable training costs and revised Exhibit G, Penalty Schedule accordingly;
- c. replaced the Schedule of Claimed Direct Cost by Contract with the Schedule of Government Cost-Reimbursement and Flexibly Priced Contracts and Subcontracts to exclude dollar values associated with the schedule of contracts; and
- d. incorporated the results of our expanded audit steps related to MAAR 5 and claimed consultant costs as discussed in Responses 2 and 3 above.

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

DoDIG Recommendation 5: Provide training to Bay States Branch Office Auditors for:

- a. developing and documenting an understanding of internal controls;
- b. completing MAAR 5, including the potential cost reductions resulting from an adequate review of the contractor's internal financial statements, to include the general ledger, trial balance and other subsidiary ledgers;
- c. incorporating appropriate report qualifications; and
- d. obtaining sufficient, appropriate audit evidence to provide a reasonable basis for the findings and conclusions on the allowability of consultant costs.

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO provided training on all four recommended areas to the Bay States Branch Office auditors on April 3 and 4, 2013.

DoDIG Memorandum No. 7 on Audit Assignment No. 4201-2012L11070001

This review disclosed no exceptions, findings or recommendations.

DoDIG Memorandum No. 8 on Audit Assignment No. 4411-2005X10100017

DCAA Overall Comments

We do not agree with all of the DoDIG's findings and recommendations contained in Memorandum No.8. The DoDIG findings are based on the audit staff not performing certain Mandatory Annual Audit Requirement (MAAR) at this corporate home office contractor. MAARs were not performed at this contractor based on the low risk assessment and the ability to perform alternative procedures.

DoDIG Recommendations: We recommend that the Director, Defense Contract Audit Agency, direct the Western Regional Director to:

DoDIG Recommendation 1: Advise the contracting officer that:

- a. the report should not be used for any purpose because the FAO did not perform sufficient tests in order to provide a reasonable basis for its opinion; and
- b. the FAO will supplement the report, as necessary, to reflect the results of the additional tests.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DCAA Response: Nonconcur.

Based on the response to recommendation numbers 2 through 7 below, we believe the FAO did perform sufficient tests (i.e., gathered sufficient appropriate evidence) in order to provide a reasonable basis for the opinion rendered; therefore, the report does not need to be rescinded.

DoDIG Recommendation 2: Begin performing MAAR 6 on a concurrent basis at the contractor facility. For contractor fiscal years where MAAR 6 was not performed concurrently, conduct labor transaction testing to verify the reliability of claimed labor costs.

DCAA Response: Nonconcur.

Mandatory Annual Audit Requirements (MAAR) 6 is a concurrent procedure to establish the reliance on the labor cost distribution records. CAM 6-404.6 and 405.3, which provide risk considerations for determining the extent of testing during labor interviews and labor floorchecks, respectively, focus on direct labor and the risk of misallocation. Generally, there is no risk of misallocation of labor at a corporate (home) office where the employees typically charge an indirect charge code which is ultimately allocated indirectly to contracts. Additionally, the government participation in each pool of this claim is significantly low. For example, the residual pool was the largest pool in the incurred cost proposal. Its government participation (i.e., allocation percentage) was 21 percent, however, reimbursement is capped at 15 percent, thus lowering the inherent risk to a significantly low level. Additionally, labor makes up less than half of the claimed pools. Unless, conditions significantly change at this location, it is very unlikely we would perform labor interviews/floorchecks in the future. Historical testing of labor (e.g., reconciliation of labor costs to books and records, executive compensation, reasonableness of compensation, and allowability of classes of compensation) would be sufficient to cover the risk of indirect labor costs at this location.

In this audit assignment, we performed alternative audit procedures to test the allowability of labor based on our assessment of risk, including:

- Reconciliation of claimed costs to the books and records;
- Allowability testing of corporate legal indirect labor; and
- reasonableness of executive compensation.

Based on the risk factors identified above and the testing performed in the engagement, we believe that sufficient competent evidence exists to support the opinion rendered on claimed indirect labor costs.

DoDIG Recommendation 3: Perform a review of MAAR 10 to identify indirect adjusting journal entries which require additional review.

DCAA Response: Nonconcur.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

While we did not review adjusting entries as a separate audit step, the risk was mitigated by the auditors including steps to review adjusting entries in our various indirect cost analysis included in the corporate cost centers determined to be the highest risk. Therefore, whenever an account was reviewed, any significant credit entries would be reviewed as part of a judgmental selection. In the case of travel where statistical sampling techniques were used, credits were included in the universe and therefore had an opportunity for selection.

DoDIG Recommendation 4: Perform a review of MAAR 15 to identify and review cost elements which show a material variance from the contractor budgetary data.

DCAA Response: Nonconcur.

We performed a comparative analysis of annual historical costs. This alternative procedure identifies significant increases or decreases in costs that require further audit analysis. These alternative procedures achieved the same audit objective required by MAAR 15.

DoDIG Recommendation 5: Determine if expanded testing is needed to incorporate DEARS criteria.

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO performed an analysis of the additional criteria in DEARS and determined that additional testing was not required.

DoDIG Recommendation 6: Reconcile IRS Forms 941 to the contractor's claimed labor and payroll taxes.

DCAA Response: Nonconcur.

The contractor files a consolidated IRS Form 941. The benefits gained from attempting a 941 reconciliation in this situation (i.e., size and complexity of contractor's organization) is not worth the benefits derived, if it can be performed at all. In lieu of performing a reconciliation of total payroll to the IRS Form 941, the FAO used other audit techniques to validate the total payroll. The FAO performed a reconciliation of the payroll to the contractor's California State Tax Return, Apportionment and Allocation of Income - Schedule R (see working paper C-03 series). Additionally, the FAO performed a reconciliation of the labor dollars and hours incurred in the FC&P base to the payroll and labor distribution records. We believe the steps performed sufficiently cover the risk.

DoDIG Recommendation 7: Prepare and issue supplemental audit report in accordance with DCAA CAM 10-214, as necessary, to incorporate the results of Recommendations 2 through 6.

DCAA Response: Nonconcur.

Based on the responses above, we do not agree with the recommendation.

DoDIG Memorandum No. 9 on Audit Assignment No. 4151-2005T10100004

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

We recommend that the Director, Defense Contract Audit Agency direct the Western Regional Director to:

DoDIG Recommendation 1: Advise the contracting officer that the FAO must:

- a. supplement Audit Report No. 4151-2005T10100004 to adjust recommended penalties and other questioned bonus costs; and
- b. supplement prior year Audit Report No. 4151-2004T10100004 to recommend disallowance of unallowable bonus costs on Contract [REDACTED]

DCAA Response: Concur.

The action to address this recommendation is complete. The FAO advised the contracting officer by issuing Supplemental Audit Report No. 4151-2005T10100004-S1 on June 28, 2013 and Supplemental Audit Report No. 4151-2004T10100004-S1 on June 14, 2013. The supplemental reports addressed the two items referenced.

DoDIG Recommendation 2: In accordance with DCAA Contract Audit Manual 10-214, instruct the FAO to supplement:

- a. Audit Report No. 4151-2005T10100004 to: (1) reflect the additional \$91,877 in questioned cost subject to penalties and \$54,196 in additional recommended penalty assessments, (2) question the two \$21,500 bonus adjustments, and (3) make appropriate adjustments to the Cumulative Allowable Cost Worksheet; and
- b. Audit Report No. 4151-2004T10100004 to: (1) question \$21,500 in unallowable direct bonus costs on Contract No. [REDACTED] Delivery Order 12; and (2) revise the Cumulative Allowable Cost Worksheet to reflect the questioned bonus cost plus applicable indirect costs.

DCAA Response: Concur.

The action to address this recommendation is complete. See our response to recommendation 1.

DoDIG Recommendation 3: Provide training to the FAO auditors on how to properly calculate and document recommended penalties.

DCAA Response: Concur.

The action to address this recommendation is complete. Training was provided to the San Diego Incurred Cost Branch Office auditors on August 28, 2013.

DoDIG Memorandum No. 10 on Audit Assignment No. 2701-2012C21000001

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendations: By June 30, 2013, the Director, DCAA should evaluate DCAA audit policy, including that specified at DCAM 9-205d, and make the revisions necessary to provide reasonable assurance that:

DoDIG Recommendation A.1: DCAA audit policy does not result in DCAA performing audits on contractor and subcontractor proposals that DCAA auditors have determined are inadequate for audit.

DCAA Response: Nonconcur.

DCAA believes that the current guidance does not require revision as it appropriately balances the needs of the customer and our role in this process. We agree, that in most circumstances, it is in the Government's best interests not to audit an inadequate proposal, however, FAR 15.404-1(a)(6) and 15.404-2(d) provide that we are to communicate with the contracting officer and he/she is to take action to acquire the required data. The regulations make the contracting officer responsible to determine whether an audit will continue given an understanding of the criticality of the warfighter requirements. Furthermore, CAM 9-205d provides that if the contracting officer decides not to return the proposal and maintains the request for audit, the audit team is to proceed with an audit to the extent practical under the circumstances. When there is a disagreement about whether to continue the audit, we inform the contracting officer that we plan to elevate the issue within our respective management chains.

Obtaining adequate proposals with sufficient supporting data is important to the acquisition process. The Department's Panel on Contracting Integrity has addressed this issue by adding a new solicitation provision in DFARS 215.408 based primarily on the requirements of FAR 15.408 Table 15-2. When a solicitation requires the submission of certified cost or pricing data, the contracting officer should include DFARS 252.215-7009, Proposal Adequacy Checklist, in the solicitation to facilitate a thorough, accurate, complete proposal. We believe this change in approach will help improve the adequacy of proposals and therefore no change in DCAA guidance is necessary.

DoDIG Recommendation A.2: DCAA audit policy will result in DCAA auditors performing contractor or subcontractor proposal audits only after the contracting officer has taken appropriate action and obtained the required data necessary to make the proposal adequate in accordance with FAR 15.408 Table 15-2.

DCAA Response: Nonconcur.

See our response to recommendation A.1. .

DoDIG Recommendation A.3: DCAA audit policy provides for DCAA notifying the OIG of an unsatisfactory condition when a contracting officer has not taken the appropriate action to obtain the required data in accordance with FAR 15.404-2(d) *Deficient proposals*.

DCAA Response: Nonconcur.

DCAA believes the current policy does not require revision as it appropriately places emphasis on communicating the need to obtain required data and elevating the matter before pursuing an

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

unsatisfactory condition. CAM 9-205d already provides policy that when the audit team does not agree with the contracting officer's decision, that he/she should elevate the issue to DCAA management and inform the contracting officer that we are doing so. FAR 15.404-2(d) provides that it is the contracting officer's action to acquire the required data from the contractor. Contracting officers consider multiple factors in their decisions to proceed with an audit, including the needs of the warfighter, which drives the schedule. It is a judgmental decision, not an automatic decision, as to whether an action rises to the level of an unsatisfactory condition. As a result, DCAA believes the current policy is effective and appropriately balanced.

DoDIG Recommendation B: By June 30, 2013, the Director, DCAA, should evaluate DCAA audit policy and determine whether policy changes are needed to ensure that in planning the audit scope and depth of DCAA proposal audits, the auditor tailors his or her audit scope and depth to obtain the minimum essential information requested by the contracting officer while still complying with Government Auditing Standards.

DCAA Response: Concur.

This recommendation relates to a miscommunication that occurred between the contracting officer and DCAA relating to the scope of the assist audit of the contractor's proposal. DCAA's policy clearly emphasizes communicating with the contracting officer to understand their needs in order to provide them with the proper service to support their acquisition. DCAA believes this situation represents an isolated instance that occurred under challenging circumstances surrounding the procurement and that its current policy satisfies the recommendation's intent. In addition, DCAA, during leadership workshops this fiscal year, emphasized the importance of better communication with contracting officers to get involved earlier in the acquisition process (before the request for proposal is issued) to help minimize miscommunications and ensure understanding of contracting officer needs.

DoDIG Recommendation C.1: By June 30, 2013, the Branch Manager, DCAA Bay States Branch Office, should provide the audit staff with training on the requirements of DCAAM Appendix D-300 Section 3, *Evaluation, Use and Impact of the Results of Government Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule*.

DCAA Response: Concur.

The action to address this recommendation is complete. On June 13, 2013, the DCAA Bay States Branch Manager provided training on the use of Government Technical Specialist assistance in audits associated with the Bay States Branch Office.

DoDIG Recommendation C.2: By April 30, 2013, the Branch Manager, DCAA Bay States Branch Office, should implement procedures that provide reasonable assurance that the audit staff has complied with the audit guidance in DCAM Appendix D *Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule* when performing price proposal audits and issuing price proposal audit reports.

DCAA Response: Concur.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

The action to address this recommendation is complete. On May 10, 2013, the DCAA Bay States Branch Manager implemented procedures that provide reasonable assurance that the audit staff has complied with the audit guidance in CAM Appendix D and CAM 9-103.8c when performing price proposal audits and issuing price proposal audit reports. These procedures include the Branch Manager review of audit assignments to ensure compliance with Agency guidance.

DoDIG Recommendation C.3: The DCAA Regional Audit Manager should perform oversight of the actions taken by the Branch Manager, Bay States Branch Office to ensure DCAA correctly implements the audit guidance in DCAM Appendix D-300 Section 3, *Evaluation, Use and Impact of the Results of Government Technical Specialist Assistance* and DCAAM 9-103.8c *Technical Evaluations Impact on Audit Report Schedule* and document the results of such oversight on a quarterly basis until corrected.

DCAA Response: Concur in principle.

We do not believe documenting results on a quarterly basis needs to be done, since this is not a systemic issue. However, the RAM will ensure that the FAO has complied with Agency guidance on the use of Government technical evaluations and will document his/her review and approval of report issuance. We believe this action meets the intent of the recommendation.

DoDIG Memorandum No. 11 on Audit Assignment No. 4821-2011R21000012

DoDIG Recommendations: The Resident Auditor, DCAA [REDACTED] Resident Office, should:

DoDIG Recommendation A.1: Provide the audit staff with training on Audit Guidance on Auditor Communications, including the applicable sections of DCAM and the DCAA standard audit program for price proposal audits.

DCAA Response: Concur.

The action to address this recommendation is complete. The staff received training on the recommended areas on April 8 and 29, 2014.

DoDIG Recommendation A.2: Provide the audit staff with training on the use of administrative working papers to document discussions and communications with the contracting officer in planning and performing the audit, including the use of working paper section 07, Government Notes/Correspondence.

DCAA Response: Concur.

The action to address this recommendation is complete. See our response to recommendation A.1.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendations: The Director, DCAA should evaluate DCAA audit policy for performing adequacy reviews of contractor proposals and make the revisions necessary to provide reasonable assurance that:

DoDIG Recommendation B.1: For any proposals that have been resubmitted due to a previous DCAA finding of inadequacy, the DCAA auditor evaluates the resubmitted proposal and determines that the proposal has been corrected for each previously identified deficiency.

DCAA Response: Concur.

The recommendation has been addressed. On February 3, 2014, DCAA implemented a Microsoft Excel-Based Proposal Adequacy Checklist Tool via MRD 14-OWD-004(R). Audit teams will use the tool to document the audit team's proposal adequacy assessment and identify specific weaknesses. The audit team will use the tool to assess any proposal resubmitted by the contractor and will keep a record of whether the corrective actions taken by the contractor effectively resolved the previously identified deficiencies.

DoDIG Recommendation B.2: The actions taken by the auditor to attest that previously identified deficiencies have been corrected by the contractor are appropriately documented in the working papers.

DCAA Response: Concur.

The recommendation has been addressed. As discussed in the response to recommendation B.1., the Microsoft Excel-Based Proposal Adequacy Checklist Tool generates adequacy assessment working papers for the audit team for each version of the proposal and maintains documentation on whether proper corrective action has occurred.

DoDIG Recommendation B.3: Where the auditor identifies in the evaluation of the current proposal that a previously identified deficiency has resulted in the contractor submitting inadequate cost or pricing data to support proposed cost, the auditor will issue a report to the administrative contracting officer identifying the business system deficiency, as appropriate.

DCAA Response: Concur.

The existing policy in CAM appropriately addresses the recommendation's intent. CAM 9-310.c requires auditors to issue a deficiency report when they identify significant cost estimating deficiencies during proposal audits. The identified significant deficiency represents a noncompliance with the estimating system requirements at DFARS 252.215-7002(d)(4). The ACO uses the reported information to make a determination on the contractor's estimating business system. CAM 9-310.d notes that a separate deficiency report is not required if the estimating deficiency has been reported previously and the contractor's corrective action is currently being monitored by the Government. However, auditors would consider this information during the risk assessment, and design appropriate audit procedures to mitigate the risk.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendations: The Director, DCAA should evaluate DCAA audit policy for auditing contractor proposed indirect rates and make the revisions necessary to provide reasonable assurance that:

DoDIG Recommendation C.1.a: DCAA audit policy results in DCAA auditors advising contracting officers when acknowledging any requests for price proposal audit assistance that DCMA forward pricing rate recommendations are available for contracting officer use in lieu of DCAA audited rates at those contractor locations where DCAA cannot provide a rate recommendation in a timely manner.

DCAA Response: Concur.

The recommendation has been addressed. As part of Better Buying Power, the Department has established a process where contracting officers can and should look for appropriate information on rates between DCAA and DCMA. In addition, DCMA's Contract Business Analysis Repository (CBAR) provides DoD PCOs access to the unique information to include rate information that DCMA maintains for the contracts it administers. We agree that better communication with the contracting officer on relevant information could improve the acquisition process. DCAA has begun working on a joint project with DCMA to assess how best to leverage DCMA's cost monitoring function in forward pricing audits. We anticipate that the results of this joint project will help assess and if necessary, improve audit policy and training in this area.

DoDIG Recommendation C.1.b: DCAA audit policy included in DCAA Audit Alert 10-PSP-018(R), dated June 4, 2010 has not unduly restricted DCAA capability to provide audit recommendations on contractor forward pricing rate proposals while complying with GAGAS.

DCAA Response: Concur.

The recommendation has been addressed. DCAA believes there is no longer a need for this audit guidance. As a result, we closed the MRD. Since the issuance of this MRD, DCAA reinforced and clarified the intent of this audit guidance and modified the forward pricing opinion language to provide the contracting community with information on the forward pricing rates more timely than in the past. Specific changes include enhancing the pro forma audit procedures used as a starting point in auditing forward pricing rate proposals and implementing a new adequacy checklist to assist audit teams in identifying inadequate proposals (MRD 12-PSP-024(R), September 2012). DCAA modified the price proposals opinion language to align with the Attestation Standards for compliance reporting (MRD 13-PSP-011(R), July 2013). Furthermore, during this spring's FAO Assistant for Quality training workshops, we are continuing to reinforce compliance reporting by enhancing other audit reports alignment with the Attestation Standards. Given these guidance reinforcements and initiatives, we have recently closed MRD 10-PSP-018(R) as it is no longer necessary.

DoDIG Recommendation C.1.c: DCAA audit policy for performing rate proposal audits at large, multi-segmented contractors like the [REDACTED] Company is providing field auditors with the right mix of audit procedures and techniques to assist DoD contracting officers in negotiating fair and reasonable contract prices while complying with Government Auditing Standards.

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

DCAA Response: Concur.

The recommendation has been addressed. DCAA, in September 2012, (MRD 12-PSP-024(R)) enhanced audit procedures and issued a new adequacy checklist for indirect rates. The new procedures included a section for audit team consideration on allocated costs from corporate, shared services and intermediate home offices. The new audit procedures are a start for auditing indirect rates and when necessary, audit teams may tailor their individual pricing proposal audits to include procedures as applicable to their situation. In addition, as discussed in response to C.1.a., DCAA has begun working on a joint project with DCMA to assess how best to leverage DCMA's cost monitoring function in forward pricing audits. Part of this project will include looking at large contractors. DCAA will assess and if necessary, improve audit policy and training in this area based on the results of this joint project.

DoDIG Recommendations: The Resident Auditor, DCAA [REDACTED] Resident Office should implement procedures that provide reasonable assurance that the auditors will advise contracting officers requesting audit assistance from DCAA [REDACTED] that:

DoDIG Recommendation C.2.a: Forward pricing rate recommendations are available from the DCMA Divisional Administrative Contracting Officer.

DCAA Response: Concur.

Due to the complexities surrounding the receipt (e.g. timing differences) of all the allocations that the Resident Office [REDACTED] receives from Corporate, Home Office, and other segments, the Resident Office is unable to complete audits of its own forward pricing rates prior to the contractor issuing a new forward pricing rate proposal. Since [REDACTED] is presently unable to provide audited rates, the [REDACTED] informs the contracting community to go directly to DCMA for forward pricing rates. DCAA will continue to audit all other cost elements.

DoDIG Recommendation C.2.b: The current status of any forward pricing rate audits and a conservative estimate on the likelihood that DCAA will complete the audit and issue an audit report in time for use by the contracting officer in negotiating the pricing action under consideration.

DCAA Response: Concur.

See response to Recommendation C.2.a.

DoDIG Recommendation C.3: Plan and begin implementing actions that will allow DCAA [REDACTED] to provide timely accounting and advisory services to the DCMA administrative contracting officer in connection with the review of the contractor's forward pricing rate proposal(s) and establishment of forward pricing rate agreements at [REDACTED]

DCAA Response: Concur.

The recommendation has been addressed. The [REDACTED] now provides the DACO with information on the local costs that are in the forward pricing rate proposals so that the DACO can use that to evaluate the forward pricing rate proposals (FPRP).

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation D: The Resident Auditor, DCAA [REDACTED] Resident Office, should implement procedures that provide reasonable assurance that the audit staff complies with the requirements of DCAM 9-103.1a and establish open channels of communication with the contracting officer that allow for the sharing of information and ideas as the audit progresses.

DCAA Response: Concur.

The recommendation has been addressed. The FAO concurs that effective communications with the contracting officer was not established and maintained. The FAO instituted practices designed to ensure proper exchange of audit concerns relative to proposal elements included in the audit request and agreement on the appropriate audit coverage required to address the contracting officer's needs. The FAO has successfully used these new practices in subsequent audits.

DoDIG Recommendation E: The Director, DCAA should take action to ensure that any DCAA price proposal audit reports issued in response to a request for audit originating from the Army Contracting Command – Redstone meet the needs of the contracting officer and can be used by the contracting officer to negotiate a contract without the contracting officer having to resort to the use of post-audit report walkthroughs and technical fact-finding summits.

DCAA Response: Nonconcur.

The subject audit report provided the contracting officer with an opinion on the proposal's compliance with FAR Part 31, DFARS, and CAS. In addition, the report gave an opinion on whether or not the proposal was acceptable for negotiation of a fair and reasonable price. DCAA expects its auditor to be involved in post-audit report walkthroughs and technical fact finding summits. As a member of the Government team we help the contracting officer prepare for negotiations and will assist as necessary.

DoDIG Recommendations: The Director, DCAA should evaluate DCAA guidance for reporting price proposal audit results in DMIS to ensure that such guidance provides reasonable assurance that DCAA:

DoDIG Recommendation F.1.a: Correctly reports dollars examined, questioned cost and net savings when

- i. DCAA did not audit and report on contractor proposed rates, and
- ii. another DoD agency provided the contracting officer with field pricing assistance for evaluating contractor proposed rates and DCAA did not assist the other DoD agency in evaluating the contractor proposed rates.

DCAA Response: Nonconcur.

We agree that DCAA should correctly report dollars examined, questioned cost and net savings in DMIS. However, the DoDIG recommendation implies that it is not correct to include dollars examined and questioned costs when DCAA did not audit and report on contractor proposed

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

rates. We disagree, the value of DCAA services and the work performed on direct costs will affect the amounts of related costs such as overhead and G&A. DCAAs current guidance (Appendix A, DCAA Guidance for Calculating and Reporting Audit Results in the DCAA Management Information System (DMIS)) provides reasonable assurance that DCAA correctly reports dollars examined, questioned costs and net savings. The Appendix A guidance for dollars examined and questioned costs on audits of parts of a proposal states: "Claim the amount for the part of the proposal audited per the audit request, plus related costs such as overhead and G&A, and profit or fee."

DoDIG Recommendation F.1.b: Correctly reports dollars examined and net savings where DCAA did not audit and report on contractor proposed profit and the contracting officer did not request that DCAA furnish any specific factual information or data related to proposed profit.

DCAA Response: Concur.

We have evaluated DCAA's reporting of proposed profit in dollars examined and determined that it correctly reflects the value of DCAA services.

DoDIG Recommendation F.1.c: Where it is determined through the review performed in items 1.a and 1.b above that the existing DMIS guidance did not result in the correct reporting of dollars examined, questioned cost and net savings in price proposal audits, consider the need to perform a self-assessment of amounts previously reported by DCAA in DMIS to ensure that such amounts are not significantly overstated.

DCAA Response: Concur.

Our initial review of Items 1.a and 1.b indicated that the existing guidance results in the correct reporting of dollars examined, questioned cost and net savings which reflects the value of DCAA services.

DoDIG Recommendation F.1.d: Document the results of the actions taken in 1.a and 1.b and the determination to perform, or not perform, a self-assessment as recommended in 1.c.

DCAA Response: Concur.

We have documented the results of the actions taken in 1.a, the results of actions taken and to be taken in 1.b, and the determination not to perform a self-assessment as recommended in 1.c. Our determination not to perform a self-assessment was based on the fact that DCAA appropriately includes related indirect expense and profit in the amounts claimed in DMIS and those amounts reflect the benefit received from DCAA audit services provided. We verified that the FAO calculations of dollars examined, questioned cost and net savings are consistent with the guidance in Appendix A and are not overstated.

DoDIG Recommendations: The Director, DCAA should

DoDIG Recommendation F.2.a: Perform a preliminary study of DMIS reporting of price proposal audit results at other DCAA locations and determine that net savings has been

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

calculated and reported in accordance with the requirements of DMIS Appendix A, Section V – Forward Pricing. This should include determining that the auditors:

- i. Carefully reviewed and compared exceptions in the audit report to the audit exceptions sustained by the contracting officer as notated in the price negotiation memorandum,
- ii. (ii). Contacted the negotiator where the price negotiation memorandum was unclear on any significant audit exceptions, and
- iii. (iii). Excluded amounts attributable to assist audits and technical reviews from the amounts reported as sustained in DMIS.

DCAA Response: Concur.

The recommendation has been addressed. DCAA performs periodic sampling of DMIS reporting of price proposal audit results at selected DCAA locations to determine that net savings have been calculated and reported in accordance with the requirements of DMIS Appendix A, Section V – Forward Pricing. We currently have procedures in place that include system edit checks, quarterly and annual memorandums to the field to review the accuracy of DMIS data, Headquarters periodic sampling of DMIS data for accuracy, and DMIS training. When DMIS data entries are noted which may indicate an error, Headquarters contacts the region and/or field audit office to determine the accuracy of the entries and ensures the entry is corrected in DMIS if needed.

DoDIG Recommendation F.2.b: Where the preliminary study performed in 2.a shows that other DCAA locations have not reported net savings in accordance with the requirements of DMIS Appendix A, Section V – Forward Pricing, perform a self-assessment of the net savings amounts previously reported by DCAA in DMIS to ensure that such amounts are not significantly overstated.

DCAA Response: Concur.

The recommendation has been addressed. Based on the periodic sampling of DMIS reporting of price proposal audit results at selected DCAA locations from 2.a above, and follow up actions taken when errors are found, we have determined that the net savings amounts previously reported by DCAA in DMIS are not significantly overstated. Therefore, there is no need to implement F.2.b. DCAA will continue to perform reviews of the dollars recorded in DMIS for significant proposals and monitor for corrective actions as appropriate.

DoDIG Recommendation F.2.c: Document the results of the preliminary study performed as a result of 2.a, and, if applicable, the self-assessment performed as a result of 2.b.

DCAA Response: Concur.

The recommendation has been addressed. We have completed and documented our assessment of DMIS reporting of price proposal audit results at selected locations through our ongoing data accuracy queries and determined that the net savings have been calculated and reported in

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

accordance with DMIS Appendix A Section V – Forward Pricing. Our assessment indicates that the integrity of our controls to detect and report errors is working properly and requires no correction.

DoDIG Recommendation F.3: The Director, DCAA should direct an internal review of the net savings reported in DMIS for DCAA Audit Report No. 4821-2011R21000012 and determine whether the amount accurately depicts any monetary benefit that may have resulted from the DCAA Audit Report No. 4821-2011R21000012.

DCAA Response: Concur.

We performed an internal review of the net savings reported in DMIS for DCAA Audit Report No. 4821-2011R21000012 and determined that the amount accurately depicts the monetary benefit which resulted from the audit. The FAO followed agency guidance when calculating and reporting net savings in DMIS. The net savings currently in DMIS accurately reflects the FAOs analysis of the PNM and is not overstated. As discussed in the response to recommendation F.1a, the recommendation implies that it is not correct to include dollars examined and questioned costs when DCAA did not audit and report on contractor proposed rates. We disagree, the value of DCAA services and the work performed on direct costs will affect the amounts of related costs such as overhead and G&A.

DoDIG Memorandum No. 12 on Audit Assignment No. 9881-2011A17100002

This review disclosed no exceptions, findings or recommendations.

DoDIG Memorandum No. 13 on Audit Assignment No. 4421-2012B21000001

DoDIG Recommendations: The DCAA Branch Manager, South Bay Branch Office should:

DoDIG Recommendation A.1: Arrange for [REDACTED] to provide the necessary training or obtain the training from a third-party source that will allow for direct electronic access to [REDACTED] records and computerized data in accordance with the requirements of the contract clause at FAR 52.215-2, "Audit and Records – Negotiation".

DCAA Response: Concur.

The recommendation has been addressed. Enterprise Accounting System (EAS) query training (required for access to the system) was provided by the contractor. All Long Beach suboffice auditors are certified to access the system. While DCAA has the ability to access the contractor's EAS system, DCAA has not been granted permission for direct access to all of the contractor's computerized systems and reports. In the event that an auditor requires information from a contractor system to which he/she does not have direct access, the auditor observes the contractor employees access the relevant system and download necessary reports.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation A.2: Establish DCAA access at all reasonable times to the [REDACTED] records and computerized data for audit, examination, or reproduction in accordance with the contract at FAR 52.215-2, "Audit and Records – Negotiation".

DCAA Response: Concur.
See our response to recommendation A.1.

DoDIG Recommendation A.3: Ensure that DCAA auditors have independent access to [REDACTED] records of any type in accordance with the contract.

DCAA Response: Concur.
In DCAA, the Contract Audit Coordinator (CAC) handles the overall coordination of contractor systems will be directly accessible by DCAA auditors. In the event that an auditor requires information from the contractor system to which he/she does not have direct access, the auditor observes contractor employees access the relevant system and download necessary reports.

DoDIG Recommendation B.1: Provide the audit staff with training on the audit policy provided in DCAM 3-204.13.

DCAA Response: Nonconcur.
We disagree with the DoDIG's finding and believe that we have provided sufficient information to address the cited concerns. The DoDIG indicated that they would consider the additional information provided to them subsequent to the exit conference. To date, we have not received any feedback from the DoDIG on the additional information.

The auditors examined documentation submitted by suppliers to the contractor in order to form their conclusions on both categories of material noted in Finding B. For the purchased parts in the amount of \$2,681,662, the auditors examined evidence related to a judgmental selection of 30 parts. For competitively bid material in the amount of \$48,511,720, the auditors examined evidence related to 48 high dollar parts and a statistical sample of 193 parts. Further, the documentation examined (e.g., e-mails originating from suppliers or documents that were signed by the supplier) came from the suppliers of the parts, not the contractor. Finally, all long term agreements supporting DCAA's conclusions for selected items were signed by the supplier's representative.

DoDIG Recommendation B.2: Take corrective action to ensure that the audit staff correctly implements the audit policy at DCAM 3-204.13 when performing price proposal audits.

DCAA Response: Nonconcur.
See our response to recommendation B.1.

DoDIG Recommendation B.3: Consider performing a defective pricing audit on the contract action resulting from the negotiation of the [REDACTED] \$119,516,041 firm-fixed price Inter-organizational Work Authorization proposal for [REDACTED] to ensure that the negotiated

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

contract price for work to be performed by [REDACTED] was not increased due to the submission of inadequate certified cost or pricing data.

DCAA Response: Nonconcur.
See our response to recommendation B.1.

DoDIG Recommendation C.1: Provide training to the audit staff on CAS 401, including CAS 401-4, "Requirements," and CAS 401-60, "Illustrations."

DCAA Response: Nonconcur.

As explained during the exit conference with the DoDIG, historical information (hours recorded by the related Resource Sub Category (RSC)'s) was provided by the contractor in support of the two summary lines of proposed labor [REDACTED] Assembly, or "touch labor" and [REDACTED] Product Support). The auditors were able to compare the proposed hours to recorded historical hours based on RSCs associated with the two summary categories of labor. The auditors were then able to assess proposed touch labor hours based on application of improvement curve theory and proposed product support hours based on historical percentages of product support to touch labor hours. The auditors' ability to make its comparison between the proposed hours and recorded hours illustrates the fact that CAS 401 compliance was not an issue in the subject proposal. A CAS 401 issue would have been indicated if the auditors had not been able to make this comparison due to an inconsistency between estimation and accumulation/reporting of hours. The auditors' evaluation of compliance with CAS 401 was an integral part of the process of comparing estimates to historical hour information.

Notwithstanding the fact that the contractor provided additional detailed information, by RSC, for its summary estimates under the two noted labor categories, it is important to consider CAS 401.40(c) in assessing the contractor's compliance with CAS 401. CAS 401.40(c) states the following: *"The grouping of homogeneous costs in estimates prepared for proposal purposes shall not per se be deemed an inconsistent application of cost accounting practices under paragraphs (a) and (b) of this section when such costs are accumulated and reported in greater detail on an actual cost basis during contract performance."* This provision (paragraph c) was excluded from DoDIG's memorandum in its citation of CAS 401.40. The contractor's summary estimates represented hours that are accumulated and reported in greater detail (i.e., by RSC) on an actual basis during contract performance. And, as noted above, the contractor provided detail by RSC in support of its summary estimates. Furthermore, the auditors were able to reconcile this detail, by RSC, to hours recorded during actual contract performance.

DoDIG Recommendation C.2: Take corrective action to ensure that the audit staff examines any estimates of direct labor costs included in price proposals submitted by [REDACTED] for compliance with CAS 401 and consider the illustration of a cost accounting practice deemed not to be consistent at CAS 401-60(b)4.

DCAA Response: Nonconcur.
See response to recommendation C.1.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation C.3: Perform an audit of the contract action resulting from the negotiation of the [REDACTED] \$119,516,041 firm-fixed price Inter-organizational Work Authorization proposal for [REDACTED] to ensure that the price paid by the U.S. Government for work estimated and proposed by [REDACTED] was not increased due to any failure on the part of [REDACTED] to comply the requirements of CAS 401.

DCAA Response: Nonconcur.
See response to recommendation C.1.

Recommendation D: Provide the audit staff with training on the requirements of DCAM Appendix D and should implement procedures that ensure that the auditors make appropriate tests of contractor data provided to and used by the DCMA technical specialist.

DCAA Response: Concur.
The action to address this recommendation is complete. On July 12, 2012 and August 2, 2012, the DCAA Quality Assurance provided the FAO with training that covered the process of requesting technical assistance. This training was provided after the audit report was issued (May 25, 2012).

DoDIG Memorandum No. 14 on Audit Assignment No. 9891-2006G10100003

DoDIG Recommendation 1: We recommend the Director, Defense Contract Audit Agency, direct the Director, Field Detachment to develop FAO procedures or guidelines to help ensure that:

- a. auditors adequately document rationale for significant budget increases prior to incurring the hours, and
- b. supervisors consider whether the requested hours are commensurate with the overall audit risk.

DCAA Response: Concur.
The recommendation has been addressed. DCAA has undertaken an initiative to ensure consistency across the Agency by eliminating publications which cover areas that should be addressed Agency-wide. The Agency has in place overall guidelines in CAM chapter 3-203.2-Developing the Programmed Hours, 3-203.3-Developing the Audit Program Steps and 3-204-Factors Influencing the Audit Scope that address risk assessment (including budgets). In addition, there are several DCAA training courses in place that address risk assessment and modifications to budgets during the course of an audit. They include CMTL 1269-Working Paper Documentation and Defense Contract Audit Institute (DCAI) course number 8565-Supervision. These courses include lessons on budgeting and how to handle changes in audit scope and/or modifications to budgets during the course of the audit based on associated risk. In addition, the Agency is conducting multiple leadership workshops that include training on

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

changes to audit risk and its impact to budgeted hours during an audit. This training is being provided to all FAO management staff throughout the Agency.

DoDIG Recommendation 2: We recommend that the Director, Defense Contract Audit Agency, revise the DCAA Management Information Systems procedures to require that Dollars Examined exclude cost allocations audited under a separate assignment, regardless of whether or not audit cognizance resides with another FAO.

DCAA Response: Nonconcur.

The dollars at issue were included in the submission of the intermediate home office and recorded in DMIS only under the intermediate home office. Although the dollars were audited under another assignment for a different segment of the same contractor in the same FAO, the dollars were not duplicated in DMIS. Frequently FAOs divide incurred cost submissions among different teams and auditors to more efficiently audit the costs. This practice saves time and produces more consistent audit results when identical cost elements for a specific contractor are incurred at the corporate, intermediate home office, and segment levels. Our review supports that the costs examined are documented in the working papers and the amounts recorded in DMIS are not duplicated, this practice is acceptable and follows the agency guidance in Appendix A.

DoDIG Memorandum No. 15 on Audit Assignment No. 6341-2005C10100010

DoDIG Recommendation 1: We recommend that the Director, Defense Contract Audit Agency direct the Regional Director, DCAA Mid-Atlantic Region to provide training to the Southern New Jersey Branch Office in the following areas:

- a. Required planning and documentation efforts for significant budget increases.
- b. Consideration of applicable risk factors in developing the transaction testing plan.
- c. Documentation of supervisory involvement and guidance.
- d. Retention of superseded working papers.
- e. Calculation of penalty participation rates.

DCAA Response 1.a, 1.b, 1.c, 1.d and 1.e: Concur.

The actions to address this recommendation is complete. The Southern New Jersey Branch Office (SNJBO) provided training at a staff conference on January 14, 2014. The SNJBO developed a FAO specific "Best Practice" working paper to formally request budget increases and/or due date extensions for supervisory approval to be documented in the audit work papers.

Attachment 18 (cont'd)

DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000

DoDIG Recommendation 2: We recommend that the Director, Defense Contract Audit Agency develop guidelines for requesting significant budget increases to help ensure that FAOs consistently document the request, need, and approval of the increases.

DCAA Response 2: Concur.

The Agency has overall guidelines in CAM chapter 3-203.2-Developing the Programmed Hours, 3-203.3-Developing the Audit Program Steps and 3-204-Factors Influencing the Audit Scope that address risk assessment (including budgets). In addition, there are several DCAA training courses in place that address risk assessment and modifications to budgets during the course of an audit. They include CMTL 1269-Working Paper Documentation and DCAI course 8565-Supervision. These courses include lessons on budgeting and how to handle changes in audit scope and/or modifications to budgets during the course of the audit based on associated risk. In addition, the Agency is conducting multiple leadership workshops that include training on changes to audit risk and its impact to budgeted hours during an audit. This training is being provided to all FAO management staff throughout the Agency.

DoDIG Memorandum No. 16 on Audit Assignment No. 1261-2007J10100537

DoDIG Recommendation 1: We recommend that the Regional Director, Defense Contract Audit Agency Eastern Region, require that the Alabama Branch Office Manager implement a procedure for helping to ensure auditors document the reasons for significant assignment delays in the working papers.

DCAA Response: Concur.

The DoDIG findings were discussed at a management meeting held on June 27, 2013. It was stressed that auditors should document the reasons for any audits that are stopped or delayed, and to maintain relevant working papers to show the basis for the delay in audits.

DoDIG Recommendation 2: We recommend that the Director, Defense Contract Audit Agency, revise Contract Audit Manual 10-210.6(a) to clarify that auditors should:

- a. coordinate with the requester when there are no findings to determine if inclusion of detailed explanatory notes would serve a useful purpose, and
- b. document the coordination in the working papers.

DCAA Response: Concur.

Contract Audit Manual 10-210.6(a) has been updated to clarify guidance that auditors should coordinate with the requestor, when there are no findings, to find out and determine if inclusion of detailed explanatory notes in our report would serve a useful purpose.

Attachment 18 (cont'd)

**DCAA RESPONSE TO THE RECOMMENDATIONS FROM
DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG)
Project No. D2013-DAPOCF-0004.000**

Our Audit Planning and Performance System (APPS), to include an additional step in our audit programs regarding coordination with the contracting officer upon completion of our audit and documentation of this coordination, is currently being updated and will be completed by June 30, 2014.



Whistleblower Protection

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